(10)

No. 90-1029

In The

Supreme Court of the United States

October Term, 1991

EASTMAN KODAK COMPANY,

Petitioner,

vs.

IMAGE TECHNICAL SERVICES, INC., J-E-S-P CO., INC.; SHIELDS BUSINESS MACHINES, INC.; MICROGRAPHIC SERVICES, INC.; MICRO MAINTENANCE, INC.; ATLANTA GENERAL MICROFILM CO., INC.; ROGER KATONA, d/b/a G. & S. ELECTRONICS; AMTECH EQUIPMENT MAINTENANCE, INC.; ADVANCED SYSTEMS SERVICES, INC.; B.C.S. TECHNICAL SERVICES, INC.; BOB INGLE, INC.; DATA PROX EQUIPMENT CO.; FISHER MICROGRAPHICS, INC.; I.O.A. DATA CORP.; SEARLE ENTERPRISES, d/b/a MICRO IMAGE, INC.; MIDWEST MICROFILM EQUIPMENT & SERVICE, INC.; OMNI MICROGRAPHIC SERVICES, INC.; and CPO, LTD.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

JOINT APPENDIX
VOLUME IV, PAGES 706-937

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Petition For Certiorari Filed December 20, 1990
Certiorari Granted June 17, 1991

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* These opinions and orders have been omitted in printing this Joint Appendix because they appear on the following pages in the Appendix to the printed Petition for Certiorari:

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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

IMAGE TECHNICAL SERVICES, INC., et al., Plaintiffs, v. EASTMAN KODAK COMPANY, Defendant.	No. C 87 1686 WWS DECLARATION OF THEODORE R. SPIES

I, Theodore R. Spies, having been duly sworn, declare and state as follows:

1. I am employed by Eastman Kodak Company as Coordinator, Marketing, Retrieval Products, for the Business Imaging Systems Division ("BISD"). In that capacity, I have responsibility for advertising, marketing and technical support for microfilm retrieval products currently sold by Kodak. I have been employed by Kodak since June 1970. I have eighteen years experience in the micrographics industry and am fully familiar with Kodak's micrographics products and the competition they face.

The facts stated in this declaration are of my own personal knowledge and I could competently testify to them if called as a witness.

2. The purpose of my declaration is to respond to the allegations of the plaintiffs in this case that existing Kodak micrographics customers are "locked-in" to Kodak. I understand plaintiffs to claim that Kodak products employ unique indexing systems which make it impossible, or at least economically impractical, for our customers to use non-Kodak retrieval devices to access their records. Those allegations are completely false.

3. Since micrographics systems typically store and manage large volumes of records, it has been commonplace for many years to index microfilm so that particular records may be retrieved automatically. In the mid-1970s, there was an industry-wide consensus that a standardized indexing system was desireable. It was believed that a standardized system would allow consumers to mix and match equipment from different vendors, and would prevent the type of lock-in that plaintiffs say exists today. Kodak shared that view and strongly supported adoption of standards.

4. In the late 1970s, the National Micrographics Association ("NMA") and the American National Standards Institute ("ANSI") worked together to develop appropriate standards. The NMA created a Micrographics Encoding Standards Committee consisting of representatives from several interested groups, including manufacturers such as Kodak, Bell & Howell, IBM and 3M. That committee drafted and approved a standard for the "blip" encoding system which had by then become the

most popular of several competing encoding systems. The standard specified the location, dimensions and density of the blip mark in great detail. The standard, entitled *Document Mark (Blip) Used in Image Mark Retrieval Systems*, was approved as American Standard on September 13, 1979 and was published by ANSI and the NMA as ANSI/NMA MS8-1979. A copy of the standard is attached as Exhibit 1 to my declaration.

5. Since adoption of the blip standard, blips have become the dominant coding/indexing system used in the micrographics industry. All equipment manufacturers, including Kodak, utilize blip coding today. I would estimate that over ninety-nine percent of all of the automated micrographics retrieval equipment sold in 1987 used the standardized blip system and that at least ninety-five percent of the automated micrographics retrieval equipment presently in use (including equipment sold prior to 1987) uses blips. Over ninety-five percent of the automated micrographics retrieval equipment Kodak sold in 1987 used blips, and I would estimate that at least eighty-five percent of Kodak's installed base of such equipment uses blips.

6. There is no lock-in as to micrographics users who use blip equipment. They may mix competing vendors' equipment as they choose, for example using Kodak cameras to film and encode their records and Canon or Minolta reader-printers to retrieve them. This happens with increasing frequency. In fact, Canon and Minolta are examples of firms that have built their market shares largely by displacing Kodak equipment from customer installations. Of course, standardization has also allowed Kodak to displace our competitors from their customers,

which we could not have done if our equipment was incompatible with theirs.

7. Plaintiffs also suggest that compatibility problems between the computer hardware and software used in the more recent, sophisticated micrographics systems create a lock-in. That is not true either. Again, there is an ANSI standard which refutes this suggestion. Entitled *Microfilm Computer Assisted Retrieval (CAR) Interface Commands,* ANSI/AIIM MS40-1987, it provides command interchange guidelines for all suppliers of computer assisted retrieval ("CAR") systems. Like the blip standard, it allows customers to mix and match components of CAR systems offered by different vendors. A copy of this standard is attached as Exhibit 2.

8. I understand the plaintiffs claim that Kodak customers who use our Miracode and Oracle indexing systems are locked-in. This is another false charge. The Miracode system, which was unique to Kodak, was discontinued in 1977. It has not been sold for eleven years. Today there are less than fifteen Miracode installations in the whole world. All other former Miracode customers have migrated to new equipment, proving that they were not locked-in to that indexing system. In fact, there are techniques to convert Miracode records to a computer index which allows any retrieval equipment with blip counting capability to retrieve Miracode film. The few remaining Miracode users are anomalies who for whatever reason prefer to use an antiquated technology as long as they can.

9. Kodak still sells the Oracle indexing system, which was developed prior to the adoption of the ANSI

blip standard. However, Oracle sales represent only a small fraction of Kodak's overall micrographic sales. In 1987, Kodak's Oracle sales accounted for less than five percent of its total sales of automated retrieval equipment, and I would estimate that of Kodak's total existing customers, less than fifteen percent use Oracle. Oracle customers tend to have less sophisticated, relatively low volume recordkeeping needs. Oracle is rarely used in high volume applications.

10. Even Oracle customers are not locked-in. Oracle codes can be read on any manufacturer's blip retrieval equipment with the aid of translation devices available on the open market. Attached as Exhibit 3 to my declaration is a brochure from Connecticut Micrographics, Inc. describing its MRS 450 Microfilm Retrieval System. This device can be attached to a wide variety of non-Kodak reader printers, and allows them to automatically retrieve Oracle film.

11. It is clear, therefore, that indexing systems do not create compatibility obstacles to existing Kodak customers who want to buy non-Kodak equipment. Moreover, the fact is that mixed equipment environments are commonplace today, proving that no one is locked in to any vendor. In fact, if technology places any role regarding a lock-in, it is to prevent it. Advances in micrographic and other image management technology are a major impetus for customers to abandon their existing equipment, including Kodak equipment, in favor of equipment which, even at a higher initial cost, promises to be more cost-effective in the long run because of productivity gains. Our customers are by and large very knowledgeable and sophisticated about the ongoing and long run

costs of managing images with micrographics and other technologies. They know the advantages and disadvantages of staying with a particular vendor or technology, and they do not hesitate to switch either if it is in their economic self-interest.

I declare under penalty of perjury that the foregoing is true and correct and that I executed this declaration on February 10, 1988 at Rochester, New York.

/s/ Theodore R. Spies
Theodore R. Spies

* * *

[Exhibits 1, 2 and 3 to Declaration of Theodore R. Spies are lodged separately with the Clerk.]

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

NO. 88-2686

IMAGE TECHNICAL SERVICES, INC., et al.,
Plaintiffs-Appellants,

v.

EASTMAN KODAK COMPANY,
Defendant-Appellee.

APPEAL FROM THE SUMMARY JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA

BRIEF OF APPELLANTS

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CERTIFICATE AS TO INTERESTED PARTIES

No. 88-2686: *Image Technical Services, Inc., et al. v. Eastman Kodak Co.*

The undersigned, counsel of record for appellants, certifies that the following have an interest in the outcome of this case:

Image Technical Service, Inc., a California corporation;

J-E-S-P, Company, Inc., a New Jersey corporation;

Shields Business Machines, Inc., a Pennsylvania corporation;

Micrographic Services, Inc., a Missouri corporation;

Micro Maintenance, Inc., an Illinois corporation;

Atlanta General Microfilm Co., Inc., a Georgia corporation;

Roger Katona d/b/a **G. & S. Electronics**, a California partnership;

Amtech Equipment Maintenance, Inc., a Minnesota corporation;

Advanced Systems Service, Inc., a Colorado corporation;

B.C.S. Technical Services, Inc., a Colorado corporation;

Bob Ingle, Inc., a Missouri corporation;

Data Prox Equipment Co, a New Jersey corporation;

Fisher Micrographics, Inc., a Missouri corporation;

I.O.A. Data Corp., a New York corporation;

Searle Enterprises, Inc., d/b/a **Micro Image**, a Texas corporation;

Midwest Microfilm Equipment & Service, Inc., a Minnesota corporation;

Omni Micrographic Services, Inc., a California corporation;

CPO, Ltd., a California corporation; and

Eastman Kodak Company, a New Jersey corporation.

These representations are made to enable judges of the court to evaluate possible recusal.

Dated: October 10, 1988

/s/ James A Hennefer
JAMES A. HENNEFER
Attorneys for Appellant

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STATEMENT OF ISSUES PRESENTED FOR REVIEW

Sherman Act Section 1

1. Do triable issues of fact exist as to whether defendant Kodak's admitted agreements with owners of its equipment not to sell them replacement parts (the tying product) unless they agree not to purchase service (the tied product) from plaintiff *or* that they will purchase service as well as replacement parts form Kodak violate Section 1 of the Sherman Act (15 U.S.C. § 1)?

2. Does this Court's holding in *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied* 473 U.S. 908 (1985), *rehearing denied* 473 U.S. 926 (1985), that *per se* tying is shown by: 1) separate "tied" products; 2) sufficient power in the tying product to appreciably restrain competition in the tied product; and 3) effect upon a substantial amount of commerce in the tied product, compel reversal of the district court's summary judgment?

Sherman Act Section 2

3. Do triable issues of fact exist as to whether defendant Kodak's change in its long-standing parts policies and its refusal to sell parts to plaintiffs, over which parts it has a "natural monopoly," violate Section 2 of the Sherman Act (15 U.S.C. § 2), where Kodak's refusal "unnecessarily excludes or handicaps competitors" pursuant to *Aspen Skiing Company v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985)?

STATEMENT OF JURISDICTION

A. Statutory Basis of Subject Matter Jurisdiction of the District Court.

The district court had subject matter jurisdiction of this action pursuant to 28 U.S.C. § 1337 and 15 U.S.C. §§ 15 and 25.

B. Finality of Judgment and Statutory Basis of Jurisdiction of this Court.

The district court granted Kodak's motion for summary judgment as to all of plaintiffs' claims pursuant to Fed. R. Civ. P. 56(b) and dismissed all claims in its "Memorandum of Opinion and Order" of April 15, 1988, which was filed on April 18, 1988. (Excerpts, pp. 64-73). The "Judgment" under Fed. R. Civ. P. 54(a) was entered April 19, 1988 (Excerpts, p. 74). This Court has jurisdiction of the appeal of the final decision of the district court pursuant to 28 U.S.C. § 1291.

C. Timeliness of Appeal.

The "Notice of Appeal" was timely filed on May 12, 1988. (Excerpts, p. 75.)

STATEMENT OF THE CASE

A. Nature of Case.

This is an antitrust action by 18 plaintiffs from 10 states throughout the United States who are independent service organizations ("ISOs"). They provide service for Kodak manufactured micrographics (microfilm) and photocopy machines. Plaintiff ISOs compete directly with Kodak for service of Kodak equipment. Their replacement parts used for such service are purchased almost exclusively from Kodak. Kodak has a natural monopoly over such replacement parts. Plaintiff ISOs are "customers" of Kodak for parts and "competitors" of Kodak for service.

Beginning in 1985, Kodak, changed its long-standing contracts, policies and practices of selling replacement parts to these ISOs who serviced Kodak equipment. Kodak has charged, and ISOs have paid and are willing to pay, high prices for replacement parts, prices which make Kodak's sales of parts a profitable business for Kodak.

The number of ISOs and the volume of their business has grown dramatically over the past ten years. Kodak's new contracts, policies and practices, instituted since

1985, are designed *not* to allow the sale of any replacement parts (directly or indirectly) to its ISO service competitors as a means of restricting their business and driving them out of business.

As to Kodak micrographics replacement parts, Kodak has sold and does sell such parts to anyone, without restrictions, *except ISOs*. Since 1985 Kodak has maintained a program to identify "BENU's" (Business Equipment Non Users) – a Kodak acronym directly equated with ISOs. Kodak has also instituted "tiger teams" to ferret out BENU's who try to order parts. Accounts of BENU's are "flagged," and parts ordered by BENU's are then severely restricted (as to older equipment parts), or totally cut off (as to newer and certain other equipment parts).

As to Kodak photocopy replacement parts, Kodak's practice since 1985 (which was different at times from its stated policy) has been to cut off the supply of replacements parts to ISOs altogether.

To prevent ISOs from providing service to Kodak micrographics or photocopy equipment owners, Kodak now will not sell replacement parts to Kodak equipment owners unless: (1) the owners install the parts themselves, and they do not employ an ISO to do so (if they have purchased the equipment directly from Kodak), or (2) the owners also purchase Kodak service (if they have not purchased the equipment directly from Kodak).

The plaintiff ISOs in this action sued Kodak on a number of theories, two of which are at issue in this appeal: **(1)** Kodak has tied its service (the tied product) to its replacement parts (the tying product) over which it has a natural monopoly, in violation of Section 1 of the Sherman Act (15 U.S.C. § 1); **(2)** Kodak has monopolized the service market by changing its long-standing policies on the sale of parts so that the new policies unnecessarily exclude or handicap Kodak's ISO competitors in violation of Section 2 of the Sherman Act (15 U.S.C. § 2).

B. Course of Proceedings and Disposition Below.

The Complaint in this action was filed on April 14, 1987. On August 14, 1987, prior to any discovery by plaintiffs, Kodak filed its notice of motion and motion for summary judgment. Kodak brought its motion for summary judgment on the basis that "Kodak's . . . policies . . . with relatively minor corrections, are as the Complaint describes them." (Record, Docket No. 19, p. 2, ll. 15-17.)

On September 18, 1987, the district court granted plaintiffs permission to take four depositions, propound one set of twenty-five interrogatories and twenty-five requests for production of documents. On January 4, 1988, the district court granted plaintiffs permission to take two additional depositions. (Record, Docket No. 41, p. 2 ll. 22-28, p. 3 ll. 26-28.) The district court refused to entertain a motion for additional discovery or to compel responses to discovery already propounded (Record, Docket No. 41, p. 3, ll. 21-28, p. 4, ll. 1-3).

The plaintiffs then filed their responsive papers and declarations. After the filing of Kodak's reply memorandum and declarations, the district court advised counsel by telephone on February 22, 1988 that oral hearing had been taken off calendar, to be reset by the court. (Excerpts, p. 79, Docket Minute Entry No. 48.) There was

no notice or resetting of the oral hearing, and, without oral hearing, on April 15, 1988, the district court issued its Memorandum of Opinion and Order which was filed April 18, 1988. (Excerpts, pp. 64-73.) Judgment against plaintiffs was entered on April 19, 1988. (Excerpts, p. 74.) The district court's order granted defendant Kodak's summary judgment on all federal antitrust claims, and dismissed all pendent state law claims for lack of subject matter jurisdiction. Plaintiffs filed a timely notice of appeal on May 12, 1988. (Excerpts, p. 75.)

STATEMENT OF FACTS.

I. The History of Kodak's Parts Policy And of ISO Service.

A. Kodak's Pre-1985 Policy on Replacement Parts.

Kodak's parts policy until 1985 was stated to its customers in the Kodak CESD ("Customer Equipment Service Division") "Replacement Parts Principles" which stated that:

> Kodak will sell replacement parts to *any party who intends to use them to repair Kodak equipment*. (Excerpts, p. 38, emphasis supplied.)

Kodak's "Terms of Sale" for parts stated:

> Kodak manufactures and stocks parts to meet the repair needs of its equipment owners, dealers, distributors, and service outlets which are repairing finished products distributed by Kodak. (Excerpts, p. 37.)

The practice was the same as the stated policy. Kodak sold parts to *anyone* using them to repair Kodak machines, to owners of Kodak equipment, and, without

conditions attached, to plaintiffs and other ISOs. (Record, Docket No. 40. Dec. of Hernandez ¶¶ 15-17; Dec. of Welch ¶ 7; Dec. of Tamvacakis ¶¶ 6, 9.)

Kodak admits that with regard to micrographics parts, there were no restrictions on the sale of parts to ISOs until the restrictions on parts which were announced in an April 12, 1985 memo to ISOs. (Excerpts, pp. 2, 14-16.) This memo is discussed below at III.A.1. Kodak also sold photocopy parts to ISOs, including plaintiffs, who serviced Kodak Ektaprint photocopy machines. (Record, Docket No. 40, Dec. of Hernandez ¶¶ 15-17.) Kodak disputes this fact, saying that it did not "knowingly" sell photocopy parts to ISOs (Excerpts, p. 29, ll. 8-9.)

Customers of Kodak parts, including plaintiffs, relied on Kodak's statements, its "Replacement Parts Principles," its "Terms of Sale," and its longstanding practice of selling parts to "*any* party who intends to use them to repair Kodak equipment." In the early and mid-1980's, ISOs began setting up businesses, first for Kodak micrographics equipment repair, and then for Kodak photocopy equipment repair, both in reliance on this policy and practice. (Record, Docket No. 40, Dec. Hernandez ¶¶ 15-17; Dec. Welch ¶¶ 6-7.)

B. The Development Of Micrographics and Photocopy ISOs for Kodak Machines.

The development of independent service organizations servicing Kodak micrographics and photocopy equipment is a relatively new phenomenon. Prior to 1982

Kodak had serviced almost 100% of its own micrographics and photocopy machines. (Record, Docket No. 41, Exhibit "E," p. 5, ll. 15-22; Docket No. 40, Dec. Hernandez ¶¶ 11, 15-16; Dec. Arnold ¶ 3; Dec. Varing ¶¶ 2-4.) Independent service organizations began to compete directly against Kodak in increasing numbers in 1984 and in 1985. Of the 16 plaintiffs in this action who service micrographics equipment, 12 of them came into existence in the 1982 period or later. (Record, Docket No. 40.) These ISOs began competing head-to-head with Kodak both for private and public sector contracts, posing a threat of increased competition, and, cutting Kodak's supracompetitive prices by up to 50% (Record, Docket No. 40, Dec. Damiani ¶ 5; Dec. Hernandez ¶¶ 9-12; Dec. Tamvacakis ¶¶ 12, 18.) In the area of photocopy parts, two months after plaintiff ITS was awarded contracts by the State of California in bidding against Kodak, for the first time parts orders to Kodak by ITS were refused. (Record, Docket No. 40, Dec. Hernandez ¶¶ 15-17, 19-22.)

Because of the direct competition of ISOs, as stated by Tim Gross of Kodak's CESD, ISOs' service became a "concern" "relevant to both BISD ["Business Imaging Systems Division" of Kodak] and CESD *performance* in 1985." (Excerpts, p. 14.) Kodak's anticompetitive actions alleged by plaintiffs in the Complaint were in direct response to this development of ISOs and the challenging of Kodak's service market dominance and supracompetitive prices for service. Kodak's action began first with the purpose to slow this growth (1985), and, then with the purpose to put ISOs out of business and out of competition with Kodak (1986). (See III.F.-III.G., below.)

C. Development of ISO Businesses

1. Development of ISOs in Kodak Micrographics Competing With Kodak On Price and Quality.

Of the 18 plaintiffs, 16 are involved in the servicing of Kodak micrographics equipment. Contrary to Kodak's suggestions in the district court, these service organizations are staffed largely by experienced, quality, Kodak-trained technicians, (Record, Docket No. 40, Dec. Damiani ¶¶ 5, 7, 13; Dec. Welch ¶ 2; Dec. Hernandez ¶¶ 3-5, 17; Dec. Tamvacakis ¶¶ 4, 5). These technicians continue to update their training at their own expense. (Record, Docket No. 40, Dec. Damiani ¶ 13; Dec. Hernandez ¶ 5.) Also contrary to Kodak's assertion to the court below, many ISOs also maintain their own large inventories of replacement parts. In fact, the inventory of plaintiff B.C.S. Technical Services is greater than Kodak's in terms of parts turnover versus volume of stock. (Record, Docket No. 40, Dec. Welch ¶ 19.) The ISOs, in order to compete against the "Kodak" name, had to provide micrographics services at a higher quality and lower price, and, if consumer choice was an indication, they did so. (Record, Docket No. 40, Dec. Damiani ¶ 5; Dec. Hernandez ¶¶ 10, 48-54; Dec. Welch ¶¶ 23-25; Dec. Searle ¶ 7.)[1]

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[1] An example of the specific improvement in both quality of service and price which micrographics dealers provided over Kodak is the contract between plaintiff ITS and Computer Science Corporation ("CSC") in Sacramento, California. ITS

(Continued on following page)

2. The Development Of Kodak Ektaprint Copier ISOs

Kodak's entry into the copier-duplicator market with the Kodak "Ektaprint" equipment line is of recent origin, in 1975. (Record, Docket No. 19, p. 9.) The total population of Kodak Ektaprint copy machines was small until the 1980's, unlike Kodak micrographics machines which had been in existence for decades. As in the micrographics industry, the new Kodak Ektaprint ISOs had to compete with Kodak both on quality and price of service. Again, they found that Kodak was obtaining supracompetitive prices for substantially lower quality service than ISOs were willing to offer.[2]

(Continued from previous page)

gave CSC a $100,000 contract where Kodak had charged $200,000, and ITS gave CSC a full time, top technician where Kodak's was part time and left machines broken after service calls. (Record, Docket No. 40, Dec. Hernandez ¶¶ 48-53.)

[2] When ITS entered into head-to-head bidding with Kodak for State of California contracts with the Mental Health Department and for the Department of Transportation, the yearly maintenance costs for these Ektaprint machines were reduced to less than 1/3 of Kodak's Equipment Maintenance Agreement ("EMA") list price. Additionally, the State of California agencies experienced an improvement in service and the response time of service. ITS was cleared to bid on additional state contracts as a result of its quality service and price, and received additional contracts from the Department of Finance and Department of Health Services. (Record, Docket No. 40, Dec. Hernandez, ¶¶ 20, 24.)

II. Kodak Micrographics and Ektaprint Copier Equipment Owners Are "Locked In" Vis-a-Vis Service.

Due to a number of factors, Kodak micrographics and photocopy equipment owners are "locked-in" to Kodak equipment despite Kodak's parts/service tie-in and supracompetitive service prices. They must have Kodak parts and service to keep their equipment operational. They do not, as a practical matter, and cannot, as a matter of "economic feasibility," switch their equipment to an "interbrand" competitor of Kodak's based solely on supracompetitive prices for service. The "lock-in" factors include: (1) the large capital expenditures in equipment (compared to the relatively small service costs); (2) the low residual equipment prices if they "switch"; (3) the high cost associated with switching formats of microfilm and records; (4) the high cost of switching applications software; (5) the difficulties created by Kodak in obtaining service and reconditioning for used equipment; and, (6) the cost associated with training new operators and adapting to a different brand of machine.

A. The "Lock-In" Of Kodak Micrographics Equipment Owners.

In the area of micrographics, Kodak equipment owners, whether employing older systems or newer systems, will not switch their existing Kodak equipment for other brands simply because of supracompetitive prices in service. This is becoming increasingly so with newer, more sophisticated equipment because of the complexity of applications, the software which links various

machines and functions in the micrographics area, and peripheral equipment which is compatible only with Kodak machines. (Record, Docket No. 40, Dec. Hernandez ¶¶ 39-47; Dec. Kastner ¶¶ 5-8.)

This "lock-in" is increased by a number of other factors as to old Kodak equipment. Because Kodak may refuse to service *very* old equipment, there is often an extremely low residual value to the equipment even though it is still very serviceable. Recoupment of any portion of the high initial capital cost is difficult if an owner tries to "switch." Without ISOs, and with the possibility of no service at all from Kodak, this lock-in effect is magnified for an owner of such equipment faced with supracompetitive service prices. Because of the age and limited use made by owners of their records which are run on older machines, an equipment owner will not pay large amounts to upgrade such records to newer equipment; rather, he will endure supracompetitive Kodak service prices to keep the machines operating. (Record, Docket No. 40, Dec. Welch ¶ 23; Dec. Kastner ¶ 7.)

As a newer equipment, such as that in the sophisticated equipment and software applications of Computer Science Corporation ("CSC") in Sacramento, California, the lock-in becomes even more pronounced. CSC has over 100 pieces of Kodak micrographics equipment. Its operations are similar to large Kodak micrographics systems in operation in Blue Cross/Blue Shield, insurance companies, banks, and other large financial institutions in many states. (Record, Docket No. 40, Dec. Hernandez ¶¶ 12, 42-47.)

The system at CSC includes a combination of micrographics machines, and of computer output hardware and software tailored specifically to CSC's needs. Trading its entire equipment for an "interbrand" competitor of Kodak, due to supracompetitive Kodak service prices, would be financially unfeasible for CSC. The special software would have to be retailored at a cost of several hundred thousand dollars. Data would have to be reformatted, and operators would have to be retrained, all at a cost of hundreds of thousands of dollars. Finally, because the residual value of CSC's Kodak equipment (which is still perfectly serviceable and well within its useful life) is so low on the used market, the net cost of purchasing new equipment less the residual value of CSC's existing equipment, would be in excess of $1.5 million. In short, CSC could, and *did*, pay supracompetitive service prices for Kodak Service of almost $100,000 more per year for service for this equipment, without considering changing to Kodak's alleged "interbrand" competitors. (Record, Docket No. 40, Dec. Hernandez ¶¶ 40-54.)

B. The "Lock In" Of Kodak Ektaprint Copier Equipment Owners

Owners of Ektaprint photocopy machines are not subject to all of the complex forms of "lock in" that sophisticated micrographics systems such as CSC's involve, but the same factors apply. The useful life of Kodak Ektaprint photocopiers is generally regarded as 14 years (Kodak gives 7 years automatic availability for an annual Equipment Maintenance Agreement ("EMA"),

plus, 7 additional years of an EMA with yearly inspections). The cost of a piece of Ektaprint photocopy equipment, however, is generally considerably more than most micrographics equipment. For example, a Kodak 150AF copier costs approximately $75,000 new. In two to three years, or the expiration of 20% of its useful life, the value of the copier will have depreciated down to $2,500 to $3,500. (Record, Docket No. 40, Dec. Hernandez ¶ 56; Dec. Arnold ¶¶ 6-8; Dec. Varing ¶¶ 16-17, 20.)

A "copy shop" will have several of these $75,000+ machines. Even with supracompetitive prices for Kodak Ektaprint service that were $2,000-$3,000 above a competitive market level per machine, it is not economically realistic for a Kodak Ektaprint owner to switch to another brand of copier. The owner is "locked into" the Kodak Ektaprint machines he owns. Kodak's own actions, in progressively restricting the availability of Kodak parts, and hence ISO service, have greatly increased the effect of this "lock in" by depressing the price of used Kodak photocopy machines. (*See* Record, Docket No. 40, Dec. Arnold ¶¶ 6-8, 32; Dec. Varing ¶¶ 16-21.)

III. Kodak's Changes In Policies and Practices in 1985 and 1986.

A. Kodak's Micrographics Policy Changes.

1. The April 12, 1985 Micrographics Policy Change.

As noted above, Kodak sold all micrographics parts to all servicers, including plaintiffs, prior to 1985. In response to the growing ISO competition for Kodak

micrographics machines, however, Kodak initiated the policy set out in the April 12, 1985 memorandum of E.A. Gross, Kodak Copy Products General Manager, and J.A. Lacy, Vice-President and General Manager of Kodak's Business Imaging Systems. (Excerpts, pp. 14-16.) Under this policy Kodak cut off completely Kodak replacement parts on new products to micrographics ISOs. The effect of this, of course, was that as customers of micrographics ISOs obtained new equipment, the ISOs were totally unable to service the Kodak equipment for that customer, and, that service for such customers was lost by the ISOs. Additionally, as equipment became obsolete, and the equipment population became all "new equipment" (post April 1985 models), ISOs would be able to service no Kodak equipment at all. (Record, Docket No. 40, Dec. Damiani ¶¶ 23, 24; Dec. Welch ¶¶ 8, 22; Dec. Kastner ¶ 8; Dec. Searle ¶¶ 4, 12, 13)

2. The July 1986 O'Brien Letter.

On July 15, 1986 (and on a continuous basis thereafter as new ISOs – "BENUS" – were identified) Kodak sent out to its ISO micrographics *service* competitors (who were also *parts* "customers") a letter from Joseph O'Brien addressed to "Customer", setting out its new policy for supply of Kodak micrographics replacement parts to Kodak micrographics service *competitors*. (Excerpts, pp. 2, 4-5.) The substance of the letter stated: (1) parts would only be sold to those who "previously and regularly" purchased parts for the same equipment model (although Kodak had no way of determining this); (2) orders would not be filled from inventory but consolidated and would

be subject to an "anticipated lead time" of "90 days or more"; (3) parts purchased by Kodak on an "all time" order basis (parts which do not regularly wear out) would not be sold to ISO competitors at all; (4) no rush orders would be available to ISO competitors; and (5) the normal 10% discount for non-rush orders would not be available to ISO competitors.

Kodak referred to its competitors as "outside entities who did not purchase equipment directly from Kodak," a group for which the Kodak acronym "BENU" (Business Equipment Non-User) was dubbed. Kodak documents equate BENU directly with plaintiffs and other ISO competitors. Kodak attempts to control the supply of parts to BENU's and ultimately to destroy them included the formation of a "**tiger team**" to search out and destroy BENU's through Kodak's parts policy. (Excerpts, pp. 52-53.) This group was also charged with the determination of what parts were critical operational parts, and, with instituting delays or methods of not selling these critical parts to BENUs (Excerpts, p. 53) Statements by Kodak's personnel, including the head of Kodak micrographics division ("BISD"), John A. Lacy, indicate a clear intent to destroy Kodak's micrographics service competitors. (Excerpts, pp. 52-53; Record, Docket No. 40, Dec. Damiani ¶¶ 15, 22; Dec. Hernandez ¶ 54.)

Kodak, while identifying BENUs and severely restricting or cutting off their parts, sold parts to others across the country – so long as they were not identified as a Kodak service competitor ("BENU") and so long as they were not identified as having a service competitor installing the parts. Parts were sold to: (1) self-servicers; (2) Kodak brokers; (3) "service bureaus" (who performed

micrographic copying on their own machines for others); (4) equipment users such as financial institutions; and (5) total strangers to Kodak with no association to micrographics machines at all (such as the "China Hutch," an English China Shop, or to non-existent individuals such as "Remy Corgi," a person's dog). (Record, Docket No. 40, Dec. Searle ¶¶ 10, 11; Dec. Tamvacakis ¶ 9.5.)

Parts orders, normally available to Kodak ISO competitors on overnight or one day basis for "rush orders," and 14 days, for "non-rush" orders, were all delayed from an average of 30 to 50 days or longer. These delays had nothing to do with parts inventories, since time and again non-competitors of Kodak, on precisely parallel orders (same part, same day, same geographical area) placed by plaintiffs through non-BENUs received overnight service on parts as to which plaintiffs were told Kodak was "back ordered" or "out of stock". (Record, Docket No. 40, Dec. Searle ¶ 9.1; Dec. Tamvacakis ¶¶ 9.2, 9.3; Dec. Kastner ¶¶ 10, 11.) Parts that were represented to ISO competitors of Kodak as being "all time" parts were denied to plaintiffs, but were sold to total strangers to Kodak because the strangers were not identified as ISO competitors (Record, Docket No. 40, Dec. Tamvacakis ¶ 9.1).

As to the persons to whom Kodak sold parts, those parts were sold on the condition that the parts were not to be resold to ISO competitors or installed by them. When it was discovered Butler Office Systems had purchased parts on behalf of plaintiff Atlanta General, an ISO competitor of Kodak, and that Butler had used ISO service to install the parts, Butler's parts were cut-off. (Record, Docket No. 40, Dec. Tamvacakis ¶ 19.)

B. Changes In Kodak's Photocopy Practice

Kodak claims that, despite its "Terms of Sale" that committed it to selling *all parts* to "*any party* who intends to use them to repair Kodak equipment," it would not and did not "knowingly" sell parts for its photocopy machines to Kodak Ektaprint ISO competitors. This is a matter of factual dispute.[3]

Kodak admits, and documents show, that Kodak has continued to sell parts to "self-servicers" of Kodak Ektaprint machines – those who only service their own machines. Kodak's sale of such parts, for example, to Top Copy in Boston, Massachusetts, were expressly conditioned to Top Copy not reselling these parts to Kodak Ektaprint ISOs or going into Kodak Ektaprint service themselves. (Excerpts pp. 51, 56.) Kodak would not sell photocopy parts to Ektaprint owners if an ISO installed them, and, as to a machine not bought from Kodak, the parts were only sold under a Kodak EMA (service contract) or Kodak per call (parts and labor). (*See*, ARGUMENT, I.A.1., I.A.2., and I.A.3., *infra*.)

[3] Paul Hernandez at ITS inquired of Kodak's CESD and was told he could purchase parts for the repair of Kodak copiers, and did so. Only after ITS competed head-to-head with Kodak on service, and the competition began to impact Kodak, did Kodak attempt to institute a detailed plan to cut-off parts to photocopy service competitors. This occurred in June, 1985, immediately after ITS's successful bids on State of California service, and just before the July 1, 1985 beginning of those contracts. (Record, Docket No. 40, Dec. Hernandez ¶¶ 15, 20-23.)

In addition, as to parts already in the marketplace, Kodak instituted a vicious campaign to prevent Ektaprint ISO competitors of Kodak from obtaining such parts. Detailed searches were made for how ITS was obtaining parts. Paul Hernandez, a former Kodak service representative with an excellent record and top technical skills, was falsely accused of ordering and stealing parts prior to his departure from Kodak. People in the industry were told that Mr. Hernandez was buying "stolen" Kodak Ektaprint copy parts. The statements were not true. (Record, Docket No. 40, Dec. Hernandez ¶ 59; Record, Docket No. 41, Exhibit "L", Kodak Docs. 2917-2920, 3058.)

An individual from Kodak's "security" forces in Rochester was sent to a Chicago leasing company, Capital Leasing, and illegally seized $25,000 worth of Kodak Ektaprint parts. (Record, Docket No. 40, Dec. Varing ¶¶ 8-11.) Additionally, the same individual from Kodak's Rochester "security" force came into the offices of CPO Limited, an Ektaprint ISO competitor in San Jose, California, demanding documents and records on a legitimately owned, brokered and resold Kodak machine, implying it too was "stolen." Again, no justification or court process was offered by Kodak for its actions. (Record, Docket No. 40, Dec. Arnold ¶ 20.)

C. Kodak's Parts Suppliers Refuse to Deal with ISOs

As a result of Kodak's cut off of parts, many ISOs attempted to purchase parts directly from Kodak's OEM parts suppliers. On non-patented parts, almost across-the-board, these parts suppliers refused to deal with

ISOs, citing arrangements with Kodak. (Record, Docket No. 40, Dec. Searle ¶¶ 15, 16; Dec. Welch ¶¶ 21, 22; Dec. Hernandez ¶ 60.) Kodak was aware of such refusals. (Record, Docket No. 41, Exhibit "L", Kodak Doc. No. 2919.)

D. Changes of Kodak's Terms of Sale and Parts Principles

Kodak changed its "Replacement Parts Principles" on December 2, 1985. This change, in part, reflected its prior changes in practice. The "Replacement Parts Principles" eliminated the statement that Kodak "will sell replacement parts to any party who intends to use them to repair Kodak equipment." Kodak modified its "Terms of Sale" on December 1, 1986, by limiting the "dealers, distributors and service outlets" to whom it would sell parts to those which were "Kodak authorized," by eliminating sales of parts to all Kodak machine owners, and by agreeing only to sell parts to "other users who purchased equipment *directly* from Kodak *and who service only their own Kodak equipment*." (Emphasis supplied.) These changes in Kodak's *written agreements* of sale reflected its revised practices to: (1) prevent purchase of parts for ISO service; and (2) cut off parts to ISO competitors in the micrographics and photocopy area. (Excerpts, pp. 39-40.)

E. Kodak Makes Substantial Profits on Parts.

Kodak in the district court advanced a "business justification" defense that it was not making a reasonable return on assets, that Kodak ISOs were "free-riding" and

that Kodak wished to save money by parts inventory control. All this is totally without factual support.

First, many ISOs have inventories of Kodak parts substantially greater than Kodak's. Plaintiff B.C.S. Technical Services, for example "turned" its parts inventory once every three years. Kodak's CESD Parts Services is able to turn its parts inventory every 60 days. (Record, Docket No. 40, Dec. Welch ¶ 19.) Other Kodak ISOs also stocked substantial parts for their service, and ordered parts well in advance.

Second, Kodak manufactures approximately 10% of its own parts. It is merely a "broker" of ninety percent (90%) of its parts which it orders, then sells at a substantial mark-up. (Record, Docket No. 41, Exhibit "L", Kodak Document Nos. 2375-2902; Docket No. 40, Dec. Welch ¶ 20; Dec. Kastner ¶ 13; Dec. Damiani ¶21.)

Further, Kodak charges ISO competitors twice what it charges for the same parts to its equipment service representatives. This price to ISOs, as of September 1, 1986 was raised by an additional 10%. Kodak's mark-up on parts sold to ISOs, where other sources are available, shows that Kodak has almost twice the mark-up of other vendors for the same parts. (Record, Docket No. 40, Dec. Damiani, ¶ 21; Dec. Kastner, ¶ 13.)

Kodak's CESD Parts Services, according to published parts policies (contrary to Kodak's implications before the district court), had *always* kept replacement parts stocks limited to its actual machine population. It "maintained [parts] . . . at a level carefully planned to fulfill Kodak's commitments" to regular servicers, self-servicers

and Kodak CESD service. (Excerpts, p. 38.) The new alleged "business justifications" offered for the 1985 reduction of parts for ISOs, were supposedly to institute parts controls. These controls had in fact existed for years and the new policy only replaced the "regular servicers" (ISOs) demand for parts with Kodak CESD's demand for parts when it took over the ISOs' service business. Both demands were the same: they simply conformed with Kodak's long-standing "Replacement Parts Principles" to stock parts for the entire Kodak machine population regardless of who serviced the machine. A simple review of Kodak's tremendous effort to attempt to ferret out its competitor BENUs, which Kodak admits resulted in less than 5% of the specially processed parts orders being denied, was considerably more expensive than any alleged savings from alleged lower parts inventories. (Record, Docket No. 41, Exhibit "L", Kodak Doc. No. 65.) It was simply geared to prevent ISO service, and to profit from Kodak service replacing it.

F. Kodak's Anticompetitive Intent

Kodak has not only manifested an anticompetitive intent in its policies and actions; it has directly stated it. The statements of Kodak's Vice-President John A. Lacy to Paul Gilbertson of CSC indicate that Kodak's BISD could control ISOs since it "has them by the balls" because of the replacement parts. (Record, Docket No. 40, Dec. Hernandez ¶ 54.) The creation of a "**tiger team**" clearly connotes predatory intent, and not a benign business interest in parts control. (Excerpts, pp. 52-53.) The illegal confiscation of parts and pressuring of ISOs are without

business justification and also demonstrate anticompetitive intent (Record, Docket No. 40, Dec. Varing ¶¶ 8-11). The timing of the parts cut-off to ITS, just after its successful bid against Kodak for State of California contracts, is likewise anticompetitive. (Record, Docket No. 40, Dec. Hernandez ¶¶ 19-23) Discussing losses to ISOs, one Kodak letter said "Parts availability for third party service is a step forward. We will need the ability to provide cost effective service as well" (Record, Docket No. 41, Exhibit "L", Kodak Doc. 3389).

G. The Effects of Kodak's Actions

The anticompetitive effects of Kodak's actions are obvious. Kodak ISOs have been unable to expand, and many have lost substantial accounts and revenues in the past two years. (Record, Docket No. 40, Dec. Hernandez ¶¶ 28, 29; Dec. Searle ¶¶ 4, 12-13; Dec. Tamvacakis ¶ 16; Dec. Damiani ¶¶ 22-23.) Customers who paid, and are paying supracompetitive prices for Kodak's service, do not have the option to bargain for lower prices and better quality service, such as Kodak owner CSC did with plaintiff ITS. (Record, Docket No. 40, Dec. Hernandez ¶¶ 46, 48-50.) ISOs, who once competed with Kodak, have gone out of business (Record, Docket No. 40, Dec. Tamvacakis ¶ 15; Dec. Hernandez ¶ 35; Dec. Welch ¶ 5).

In the Kodak photocopier area where ISOs are fewer, and more easily identified, the situation is worse. Kodak has identified most ISOs and will prevent sales of parts to anyone using their service as well as to the ISOs directly. (Record, Docket No. 41, Dec. Hennefer, Exhibit "L," Kodak Document Nos. 2912-2938.) The market for used

photocopiers has greatly diminished in number of machines, *and* in value. Owners, locked-in by the low residual values (which is not alleviated by Kodak's high trade-ins since they are then required to buy more Kodak machines), are not selling their machines, since these represent investments that, for example, cost $75,000 a few years ago and now have a value of $2500. They simply pay the supracompetitive Kodak service prices, or, rarely, risk the parts problem with an ISO (Record, Docket No. 40, Dec. Varing ¶ 17; Dec. Hernandez ¶ 41; Dec. Arnold ¶ 7).

Unlike the market for service of IBM and Xerox photocopy machines, and that of Micron, Microdesign and Fuji for micrographics machines, the market for service of Kodak equipment is moving toward a total Kodak monopoly and supracompetitive prices again. The San Francisco Bay Area, where Kodak ISO service was alive, will soon not have these competitors as to which the Kodak district manager said:

> "Kodak's price was twice that of [plaintiff] ITS. Of course we lost the bid. To date they [the customer] have received an average of two hour response time, no problems with parts, and overall are very satisfied with the quality of service they have received from ITS. (Excerpts, p. 59.)

The severe detriment to consumers in the marketplace because of the loss of such service, in terms of price, quality and availability of the product at issue – Kodak micrographics and photocopy service – cannot be seriously refuted.

STANDARD OF REVIEW

This Court is to "review *de novo* the district court's grant of summary judgment, viewing the evidence in a light most favorable to the losing party," plaintiffs-appellants. *Dimidowich v. Bell & Howell*, 803 F.2d 1473, 1477 (9th Cir. 1986); *Compton v. Ide*, 732 F.2d 1429, 1434 (9th Cir. 1984).

Summary judgment is generally disfavored in antitrust litigation. *Poller v. Columbia Broadcasting System*, 368 U.S. 464, 473 (1962); *Dimidowich, supra*, 803 F.2d at 1477.

In *Poller*, the Supreme Court cautioned against the improper use of summary judgment in complex antitrust cases, stating:

> We believe that summary procedures should be used sparingly in complex antitrust litigation where motive and intent play leading roles, the proof is largely in the hands of the alleged conspirators, and hostile witnesses thicken the plot. . . . Trial by affidavit is no substitute for trial by jury which so long has been the hallmark of "even handed justice." 368 U.S. at 473.

Summary judgment may be an appropriate method to test the validity of the underlying antitrust theory in certain cases, but only if – without controverting the validity of the plaintiff's factual contentions – the acts of defendant, do not amount to an antitrust violation as a matter of law. *See, Mutual Fund Investors, Inc. v. Putnam Management Co.*, 553 F.2d 620 (9th Cir. 1977). This is not the case here.

The case of *Matsushita Electric Industrial Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 106 S.Ct. 1348 (1986) has not changed this principle one iota, but has reinforced it.

There, plaintiffs' claim of predatory pricing was found to be implausible and to make no economic sense even if all the facts asserted were true. Here, it is Kodak's "defense" of "interbrand" competition, in the situation when a Kodak machine owner needs parts and service for his machine that is broken down, that makes no economic sense. As this Court stated as to a similar "defense" in *Dimidowich v. Bell & Howell*, 803 F.2d 1473 (9th Cir. 1986):

> " . . . an owner of broken B & H micrographic equipment is indifferent to people who can service Kodak or 3M machines. If the owner's only option is to request service from B & H or Comgraphix . . . that is obviously the market the owner faces." *Id.* at 1480-1481 n.3.

The Ninth Circuit also reaffirmed the validity of *Poller* in *Dimidowich*:

> Although summary judgment generally is disfavored in antitrust litigation, [citations omitted] it appropriately may be granted if the nonmoving party does not show any issues of material fact and does not present an adequate record to support a finding in his favor. *Filco v. Amana Refrigeration, Inc.*, 709 F.2d 1257, 1260 (9th Cir.), *cert. denied*, 464 U.S. 956, 104 S.Ct. 385, 78 L.Ed.2d 331 (1983).

Where, as here, valid antitrust theories are alleged, the district court conceded plaintiffs' relevant market for purposes of its decision and there is substantial evidence of anticompetitive intent and anticompetitive effect (which evidence is claimed by defendant to be insufficient as a matter of law) summary judgment should be sparingly granted. *See, e.g., Aydin Corp. v. Loral Corp.*, 718 F.2d 897 (9th Cir. 1983); *Impro Prods, Inc. v. Herrick*, 715 F.2d 1267 (8th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984);

Battle v. Lubrizol Corp., 513 F.Supp. 995 (E.D. Mo. 1981), *aff'd by equally divided court* (en banc), 712 F.2d 1238 (8th Cir. 1983), *cert. denied*, 466 U.S. 931 (1984).

SUMMARY OF ARGUMENT

I. SECTION 1, SHERMAN ACT.

Under Section 1 of the Sherman Act, Kodak's policies and practices of: (1) refusing to sell parts to a customer if he uses ISO service and (2) selling parts to used machine purchasers and others only if they agree to purchase Kodak service, are classic tying arrangements under *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5-6 (1958). Kodak is tying service (the tied product) to parts (the tying product). Kodak admits it has a natural monopoly over these parts. Whether the tying arrangement is a *per se* violation under *Digidyne Corp. v. Data General Corp*, 734 F.2d 1336 (9th Cir. 1984), or, is merely an unreasonable restraint of competition under the rule of reason involves material issues of fact.

II. SECTION 2, SHERMAN ACT.

As a monopolist in replacement parts, Kodak may not refuse to deal with a parts *customer* who is also a *competitor* in a different area (and at a different level of distribution) like service, where its change in a long-standing policy "unnecessarily excludes or handicaps competitors." *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985). The Ninth Circuit has long recognized that the antitrust laws impose duties on a monopolist to sell to an existing customer under certain

circumstances even if that means aiding its competitors. *Pacific Coast Agricultural Export Ass'n. v. Sunkist Growers, Inc.*, 526 F.2d 1196 (9th Cir. 1975), *cert. denied*, 425 U.S. 959 (1976). *See Oahu Gas Service, Inc. v. Pacific Resources, Inc.*, 838 F.2d 360 (9th Cir. 1988).

ARGUMENT

I. KODAK'S AGREEMENTS WITH ITS EQUIPMENT OWNERS CONSTITUTE AN ILLEGAL TYING ARRANGEMENT UNDER SECTION 1 OF THE SHERMAN ACT, AND THIS COURT'S *DIGIDYNE* OPINION REQUIRES REVERSAL.

As noted above, the district court's summary judgment was granted without oral argument. Perhaps as a result of this lack of argument, the district court's memorandum opinion significantly misstates the facts and misapplies the law of this Circuit with respect to plaintiffs' tying claims. As demonstrated here, admissions in defendant Kodak's own declarations and its own documents, when analyzed under the microscope of the Supreme Court's rule in *Northern Pacific Ry.* and this Court's rule in *Digidyne*, require reversal of the judgment of the district court.

A. Kodak Service Is Tied To Kodak Parts.

Kodak's written "Terms of Sale" and the declarations Kodak submitted in support of its motion for summary judgment establish that Kodak's policy is to refuse to sell replacement parts (the tying product) for its equipment to those owners who desire to purchase service (the tied product) from an ISO. The district court came close, but

did not quite grasp, this fundamental and crucial fact upon which plaintiffs' tying claims turn. The opinion notes that:

> With respect to copier-duplicators, Kodak has since 1975 not knowingly sold parts to anyone other than direct purchasers of that equipment.

(Excerpts, p. 65, ll. 13-15.)

The opinion goes on to find that:

> Since 1985, Kodak has also sold imaging [micrographic] equipment parts only to purchasers of such equipment, with certain qualifications not material here.

(Excerpts, p. 65, ll. 19-21.)

The opinion also finds that:

> The effect of these practices is to generally bar sales of parts required to repair and maintain Kodak copiers and imaging equipment to plaintiffs and other ISO's.

(Excerpts, p. 66, ll. 1-3.)

But in reaching the tying claim, the district court *erred* in stating: "A Kodak customer . . . can buy parts if he simply owns Kodak equipment." (Excerpts, p. 68, ll. 11-13.)

That statement is flatly wrong and is contradicted by submissions in the record below from both Kodak and plaintiffs. A Kodak customer *cannot* "buy parts if he simply owns Kodak equipment." There are three major exceptions to this statement which Kodak *admitted*: (1) The customer cannot buy parts if it uses an ISO to service its equipment (the "ISO-serviced owner"); (2) The customer cannot buy parts if it acts as an ISO and installs those

parts in another party's machine (the "owner - ISO"); (3) The customer cannot buy parts alone, but only parts *and* service, if it purchased Kodak equipment from a seller other than Kodak (the "brokered-equipment owner"). In each of these cases, the customer can buy parts only on the condition that it not buy service from an ISO, or, that it buy both parts *and* service from Kodak.

The district court's misunderstanding of Kodak's *conceded* restrictions on sales of its parts resulted in an incorrect application of the law, and an erroneous granting of summary judgment. Kodak's refusal to sell parts to the ISO-serviced owner, the owner-ISO and the brokered-equipment owner, *unless* those owners *also* refuse ISO service or purchase Kodak service, constitutes a tying arrangement which under the circumstances here is illegal *per se* and constitutes an unreasonable restraint on competition.

1. A Kodak Machine Owner Cannot Buy Parts If It Uses ISO Service.

Kodak admits it will not sell parts to an ISO-serviced owner. Kodak's "Replacement Parts Principles," newly instituted on December 2, 1985, state that parts levels were carefully planned only for, *inter alia*, "users of Kodak equipment *who service their own equipment*." (Excerpts, p. 40, emphasis supplied.)

Kodak's "Terms of Sale" for replacement parts, newly instituted on December 1, 1986, clearly state that Kodak parts are stocked only for users "who service only their own Kodak equipment." (Excerpts, p. 39.)

As Kodak's BISD Vice President and General Manager, Mr. John A. Lacy, swore in his declaration in support of Kodak's motion for summary judgment:

> Kodak's customers are free to obtain service from ISOs or to perform their own service; *in the latter case* they may freely obtain parts from Kodak.

(Excerpts, p. 26, ll. 9-11, emphasis supplied.)

Michael J. Murray, another Kodak declarant on its motion for summary judgment who is Vice President and General Manager for the Kodak Copy Products Division, stated:

> It is Kodak's business practice to sell parts, publications and tools for the repair and maintenance of our copiers only to our direct copier customers *who want to service their own equipment*.
>
> * * *
>
> In fact, customers have the option of purchasing Kodak service (on either a per call or EMA basis) or ISO service, or servicing their own copiers. *If they choose to service their own*, they may obtain parts from Kodak.

(Excerpts, p. 19, ll. 16-19 and p. 20, ll. 6-9, emphasis supplied.)

In other words, if the Kodak customer "chooses" not to service its own equipment, but rather purchases service from an ISO, the customer *cannot* obtain parts from Kodak. This was confirmed in the deposition of Lynn M. Gleason, Kodak's replacement parts coordinator, who admitted that Kodak would *not* sell parts to a Kodak customer who purchased equipment from Kodak but used an ISO to install those parts:

Q. Okay. Can self-servicers buy parts for Ektaprint photocopy machines *to be installed by a third-party service organization?*

. . .

A. A customer *who is servicing their own equipment* can buy parts from Kodak, *period.*

Q. And when you say "period," you mean, don't you, that *they have to put them in their own machine?*

A. *Yes.*

. . .

MR. WALL [the witness' attorney]: . . . [He is asking you] [w]hether as a matter of policy Kodak will sell to a customer so that they may have an *independent service organization service that customer's machine.*

A. Well, *that's not consistent with self-servicing.*

(Excerpts, p. 49, l. 16 – p. 50, l. 19, emphasis supplied.)

Kodak's interrogatory responses confirm this. When asked whether Kodak sold replacement parts to direct purchasers of Kodak equipment for servicing of that equipment by "independently contracted labor," Kodak responded:

> [A]ssuming that "independently contracted labor" refers to ISOs: Kodak prefers not to sell newer micrographic equipment parts or copier parts under these conditions. However, Kodak has no effective means to prevent direct equipment customers from purchasing parts, ostensibly to perform their own service, when in fact they have an ISO service their equipment. Kodak suspects that it has sold parts to its customers under these conditions.

(Excerpts, p. 30, ll. 14-18 and p. 31, ll. 5-13.)

Documents produced by Kodak and relied on by plaintiffs in the district court confirm that Kodak was quite successful in achieving its "preference" not to sell parts to ISO-serviced owners. These documents prove that Kodak routinely implemented this policy and regularly refused to sell parts to its customers who purchased equipment from Kodak but preferred to use ISO service. For example, when a bank which "own[ed] their own copier" and "purchased it from [Kodak]" needed a part and wanted an ISO to install it, Kodak's Ms. Gleason told the ISO "we [Kodak] will not be selling them [the ISO] the part" but that "we would sell [the bank] the part *if [the bank were] servicing the unit themselves.*" (Excerpts, p. 57, emphasis supplied.)

Thus, Kodak admits that it has an agreement with each purchaser of its copier or micrographic equipment that it will not to sell parts unless the equipment owner agrees not to buy service from an ISO. This is a black-letter-law tying arrangement and, as demonstrated below, constitutes a *per se* violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

2. A Kodak Machine Owner Cannot Buy Parts If It Is An ISO.

A necessary corollary to Kodak's requirement that a Kodak machine owner may not buy parts if it uses an ISO to install them is that the customer may not act as an ISO on other parties' machines or sell the parts to an ISO. Kodak's Ms. Gleason confirmed that "[owners] have to put [the parts] in their own machine." (Excerpts, p. 49, l. 25 – p. 50, l. 3.) For example, with regard to "Top Copy"

and "Legal Copy Center – Harvard Law School" in Boston and Cambridge, Massachusetts, Ms. Gleason stated:

> "10/21/85 . . . [T]here is a possibility that Legal Copy/Top Copy is expanding their services by offering Facilities Management [for others], and that they may be performing service on the units in addition to actually making the copies. . . . if we can confirm this situation, that Legal Copy has become a competitor, . . . we will no longer sell them Copy Parts."

(Excerpts, p. 56.)

3. A Kodak Brokered-Machine Owner Cannot Buy Parts Unless It Buys Kodak Service.

Kodak admits it will not sell parts to a brokered-equipment owner. Kodak will *only* sell such a customer an Equipment Maintenance Agreement ("EMA") or "per call" service whereby they are supplied with both parts and service. Kodak's Mr. Lacy declared:

> [W]e [Kodak] decided that we would not sell parts on new micrographic products . . . except to direct Kodak equipment customers.

(Excerpts, p. 24, l. 23 – p. 25, l. 1.)

Kodak's Mr. Murray declared that Kodak's copier parts policy is the same:

> We [Kodak] do not knowingly sell parts, publications or tools to . . . individuals or firms who wish to service Kodak copiers they have purchased from sources other than Kodak.

(Excerpts, p. 19, ll. 19-23.)

Kodak's interrogatory responses succinctly state this policy:

> Kodak does not knowingly sell newer micrographic parts or copier parts, other than pursuant to an EMA [a Kodak service agreement] or an [sic] a per call [Kodak service] basis, to persons who do not own micrographic or photocopy equipment which they purchased directly from Kodak.

(Excerpts, p. 29, ll. 8-12.)

As with its ISO-serviced policy, Kodak is highly efficient in policing its brokered-equipment policy to insure that no owner of Kodak equipment purchased from a non-Kodak source can buy parts. Kodak documents relied on by plaintiffs below are replete with examples of Kodak personnel utilizing sophisticated computerized serial-number tracking systems to insure that Kodak does not sell parts to brokered-equipment owners who do not also use Kodak service. For example, records of Kodak's Ms. Gleason stated:

> 2/26/87 Carm from PS [Parts Service] had called me 2/13 at 5:00 and asked me to check on this company [Copier Services Unlimited] who had placed a part order for a unit they bought from CPO Ltd. [a broker]. S/N 468230 150AF. . . . I called the district in Kansas City and they said they do not have a customer called Copier Services Unlimited and I asked to have SCAN check the S/N and I was told that we don't have a unit by that serial number. So I called Jim Murphy to inform him that we only sell copier parts to Copy Product customers who purchase their equipment from Kodak.

(Excerpts, p. 55.)

Kodak's Ms. Gleason further stated:

> Kodak supports their customers . . . we would not sell them parts if they purchase the unit from a broker and service the unit themselves because as far as Kodak is concerned, we are not involved in any of these transactions and do not recognize them as a customer.

(Excerpts, p. 54.)

Kodak's refusal to sell parts to a brokered-equipment owner unless the owner also buys Kodak service constitutes a tying arrangement, just as does Kodak's refusal to sell parts to ISO-serviced owners.

B. The Tying Standard of Northern Pacific.

The district court quoted the long-standing Supreme Court definition of a tying arrangement given in *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5-6 (1958):

> A tying arrangement is 'an agreement by a party to sell one product but only on the condition that the buyer also purchase a different (or tied) product, or at least agree that he will not purchase that product from any other supplier.'

(Excerpts, p. 67, l. 21 – p. 66, l. 3.)

Unfortunately, because the court below did not understand that Kodak's policy is to sell parts to owners *only on the condition* that: 1) they purchase parts *and* service from Kodak; *or* 2) that they agree not to purchase service from an ISO, the court failed to recognize that Kodak's agreements fall within the literal language of both the first ("on the condition") and the second ("or at least") clauses of *Northern Pacific's* definition of a tying arrangement. To

paraphrase the *Northern Pacific* definition, there is admittedly here "an agreement [with owners of Kodak's equipment] by a party [Kodak] to sell one product [parts] but only on the condition that the buyer purchase a different (or tied) product [service or brokered machines] or at least agree that it will not purchase that product [service] from any other supplier [i.e., an ISO]."

As noted above, Kodak will only sell parts *and* service together for brokered equipment. Further, Kodak admits that it will sell replacement parts alone to an owner who purchased its equipment directly from Kodak *only* if the owner physically installs those parts itself, *i.e.*, provides its own service and hence does not buy service, the tied product, "from any other supplier, such as a plaintiff ISO" The owner must also install all parts it purchases in its own machine, and not, as Ms. Gleason said, "become a competitor" with those parts. The owner has but two choices to buy parts from Kodak: 1) buy parts from Kodak and fix its purchased-from-Kodak equipment itself, or 2) buy *Kodak* service, in which case it also obtains parts for its equipment. But it cannot buy parts from Kodak, hand them to its ISO, and have that ISO install the part for less than Kodak charges. *That* is a tying arrangement, which effectively ties Kodak service to Kodak parts. Kodak parts *cannot* be purchased separately from Kodak service by ISO-serviced owners, by ISO-owners, or by brokered-equipment owners.

C. The Existence of Kodak's Admitted Tying Arrangement Requires Reversal to Afford Plaintiffs the Opportunity to Show Unreasonable Restraint of Competition or Per Se Illegality Under Digidyne.

1. Triable Issues of Fact Exist with Respect to the Unreasonable Restraint of Competition Engendered by Kodak's Tying Arrangement.

Digidyne Corp. v. Data General Corp., 734 F.2d 1336 (9th Cir. 1984), *cert. denied* 473 U.S. 908 (1985), reiterated the well-established proposition that:

> A tying arrangement is illegal if it is shown to restrain competition unreasonably or is illegal *per se*, without such a showing, if certain prerequisites are met.

734 F.2d at 1338.

Here, because the district court did not recognize that Kodak's agreements with equipment owners constituted an arrangement tying Kodak service to Kodak parts, it incorrectly concluded that "plaintiffs have not demonstrated the existence of a tying arrangement." (Excerpts, p. 67, ll. 20-21.) Accordingly, because of this incorrect factual understanding, the district court dismissed plaintiff's tying claims without ever reaching the question of whether these arrangements are illegal, because they restrain competition unreasonably, *or* are illegal *per se* because the required prerequisites are met. Reversal is required on this ground alone, to afford plaintiffs discovery and trial on the issue of whether Kodak's tying arrangement unreasonably restrains competition.

However, because plaintiffs' showing in opposition to Kodak's motion for summary judgment did, in fact, demonstrate the existence of triable issues of fact regarding the three prerequisites for *per se* illegality of a tie-in, plaintiffs proceed, in this brief, to discuss those three elements. Plaintiffs demonstrate, at a minimum: that triable issues of fact exist with respect to each element, that plaintiffs came forward with evidence showing the existence of each element, that summary judgment was therefore improperly granted, and that the judgment below must be reversed.

2. Triable Issues of Fact Exist with Respect to the *Per Se* Illegality of Kodak's Admitted Tying Arrangement.

As *Digidyne* states,

> The prerequisites of *per se* illegality are: (1) separate products, the purchase of one (tying product) being conditioned on purchase of the other (tied product); (2) sufficient economic power with respect to the tying product to restrain competition appreciably in the tied product; and (3) an effect upon a substantial amount of commerce in the tied product.

734 F.2d at 1338.

a. Parts and Service Constitute Separate Products.

The first element, separate products, is satisfied here. The tying product of parts is separate and distinct from

the tied product of service. A service constitutes a "product" for purposes of a tying arrangement under the Sherman Act. *Northern Pac. R. Co. v. U.S.*, 356 U.S. 1, 3 (1958) (railroad shipping services constituted tied product). The test of whether the alleged separate products constitute one or two products "turns not on the functional relation between them, but rather on the character of the demand for the two items," *i.e.*, that there are "two distinct markets for products that were distinguishable in the eyes of buyers." *Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2, 19 (1984). Kodak's admission that many of its equipment owners would prefer to purchase service from ISOs while purchasing parts from Kodak (if Kodak's tying arrangement did not prohibit it) demonstrates that the parts and service are clearly distinguishable products in the eyes of buyers. (*See* testimony of Kodak witnesses Lacy, Murray and particularly Gleason, quoted above. (pp. 22-26.)

Despite these admissions of its personnel, Kodak in its reply memorandum below made a half-hearted effort to suggest that customers view parts and service as the same product:

> Similarly, there is no demand for parts distinct from the demand for service. Parts have no utility or economic value unless they are used to service the equipment that is made up of those parts. Parts are not a separate product to which either equipment or service can be tied.

(Excerpts, p. 62, ll. 11-16, footnote omitted.)

While this argument is clearly sophistry and is not based on *evidence*, at a minimum it raises a triable issue of fact, requiring reversal of Kodak's summary judgment.

b. Kodak Possesses Sufficient Economic Power With Respect to Parts to Restrain Competition in Service.

Plaintiffs also made a sufficient showing that there are triable material issues of fact on the second element of a *per se* violation: Kodak's "possession of sufficient economic power with respect to the tying product," which in this case is replacement parts. *Digidyne, supra*, 734 F.2d at 1339.

As *Digidyne* teaches, possession by the seller in a *per se* tying case of "monopoly power is sufficient to establish *per se* illegality, *but it is not required.*" *Id.* at 1339-340 (emphasis supplied). Rather,

> [T]he crucial economic power may be inferred from the tying product's desirability to consumers or from uniqueness in its attributes.

Id., at 1340, *quoting U.S. v. Loews, Inc.*, 371 U.S. 38, 45 (1962).

In further analyzing the economic power needed, this Court in *Digidyne* turned to the Supreme Court's decision in *Fortner Enterprises v. U.S. Steel Corp.*, 394 U.S. 495, 502-04 (1969) (*Fortner I*), and emphasized:

> The standard of 'sufficient economic power' does not, as the District Court held, require that the defendant have a monopoly or even a dominant position throughout the market for the tying product. Our tie-in cases have made unmistakably clear that the economic power over the tying product can be sufficient even though the power falls far short of dominance and *even though the power exists only with respect to some of the buyers in the market. . . .*

> [T]he presence of any appreciable restraint on competition provides a sufficient reason for invalidating the tie. Such appreciable restraint results *whenever the seller can exert some power over some of the buyers in the market, even if his power is not complete over them and over all other buyers in the market.*

Digidyne, supra, 734 F.2d at 1340 (emphasis by the Ninth Circuit).

Relying on the Supreme Court's latest pronouncement on *per se* tying arrangements, *Jefferson Parish, supra,* this Circuit in *Digidyne* declared:

> [A] tying arrangement is illegal *per se* if the seller of the tying product has the capacity to *force* some buyers to purchase a tied product they do not want or *would have preferred to purchase elsewhere.* When such forcing occurs "competition on the merits in the market for the tied item is restrained." *Jefferson Parish Hospital,* ___ U.S. ___, 104 S.Ct. at 1558 (1984). Thus, what is required in a *per se* case is not power over the whole market for the tying product, but only as the Court said, a "type of market power [that] has sometimes been referred to as 'leverage . . . defined here as a supplier's *ability to induce his customers for one product to buy a second product from him that would not be purchased solely on the merit of that second product.*' " *Id.* at 1559 n. 20 quoting V.P. Areeda & D. Turner, *Antitrust Law,* ¶1134a at 202 (1980). "[W]e have condemned tying arrangements," the Court said, "when the seller has *some special ability* – usually called 'market power' – *to force a purchaser to do something that he would not do in a competitive market.*" *Id.* at 1559.

Digidyne, supra, 734 F.2d at 1340-41 (emphasis supplied).

Jefferson Parish, supra, provides an excellent and exhaustive analysis of the degree of "economic power" in the tying product (parts) necessary to restrain competition appreciably in the tied product (service). Applying the words of *Jefferson Parish* (adopted by this Circuit in *Digidyne*) to the facts at bar, Kodak must be shown to have "*some special ability* . . . to *force* a purchaser to do something he would not do in a competitive market." *Jefferson Parish, supra,* 466 U.S. at 13-14 (emphasis supplied).

The Supreme Court in *Jefferson Parish* identified a variety of "special abilities to force," a number of which apply here. As is first example, it reasons that "if the Government has granted the seller a *patent* or *similar monopoly* over a product, it is fair to presume that the inability to buy the product *elsewhere* gives the seller market power." 466 U.S. at 16 (emphasis added). Here, some of Kodak's parts (and service manuals) are patented (or copyrighted). Kodak's current ability to refuse to sell its parts directly to ISOs and to require manufacturers of its parts to so refuse, creates a "similar monopoly" in Kodak parts which precludes anyone from purchasing Kodak parts "elsewhere." While plaintiffs accept the district court's observations that "Kodak has, of course, a natural monopoly over the market for parts it sells under its name" and that in some instances, "the right of a manufacturer unilaterally to select its customers and to refuse to sell to others is well-established . . . " (Excerpts, p. 71, ll. 1-2, p. 68, ll. 21-23), cases holding that do not validate a tying arrangement by a seller of unique parts. Rather, Kodak's natural monopoly assists plaintiffs on

their tying claim in demonstrating Kodak's "ability to force."

Moreover, the uniqueness of Kodak's parts – alone – constitutes another basis recognized by the Supreme Court for demonstrating Kodak's power in the tying product market. *Jefferson Parish, supra,* 466 U.S. at 17. Kodak itself in its interrogatory responses refers to its "unique" parts: "Kodak has never intentionally deviated from its policy not to sell unique copier parts to independent service organizations." (Excerpts, p. 28, ll. 14-15.)

Although the recognition by the court below that Kodak has a "natural monopoly over the market for parts it sells under its name. . . . " (Excerpts, p. 71, ll. 1-2) may not, as the district court held, impose a "duty" on Kodak to sell to plaintiffs, it *does* raise triable issues of fact as to whether that natural monopoly gives Kodak "some ability to force" its equipment owners to buy its service by reason of its tying arrangements.

Finally, plaintiffs' proferred evidence on these factual issues – which was never discussed by the district court – is substantial. Plaintiffs have shown that many of Kodak's equipment owners "would have preferred to purchase [service] elsewhere," namely, from plaintiff ISOs, but could not because then Kodak would not sell them parts. (Record, Docket No. 40, Dec. Hernandez ¶¶ 24, 30-32, 35; Dec. Damiani ¶¶ 4-5, 11; Dec. Welch ¶¶ 23-25.) Plaintiffs have shown that Kodak has the "ability to induce [its] customers for one product [parts] to buy a second product [service] from [it] that would not be purchased solely on the merit of that second product," because Kodak's service was inferior to and costlier than that of the ISOs.

As Kodak's own documents concede: "Third party providers [ISOs] are offering service at 30% less and providing in the customers [sic] eyes comparable service. Service is being provided by two former Kodak ESR's who are well trained and talented." (Excerpts, p. 58.) And plaintiffs showed that Kodak had "some special ability . . . to force a purchaser [of parts] to do something he would not do in a competitive market," namely, buy Kodak's supracompetitively priced service, because parts are unavailable to the equipment owner who rationally prefers an ISO's competitively priced service. (Record, Docket No. 40, Dec. Hernandez ¶¶ 24, 30-33, 35; Dec. Damiani ¶ 4-5, 11; Dec. Tamvacakis ¶¶ 12-13.)

i. A *Digidyne* "Lock-In" Enhances Kodak's Power Here.

This Court further explained that plaintiffs in *Digidyne* had shown, after a full-blown trial on the merits, that the "power to coerce" which the tying product gave to the defendant "was enhanced by the fact that many of defendant's customers were 'locked in' to the use of [the tying product]," in part because of a sizeable economic investment. 734 F.2d at 1342. In their showing in opposition to Kodak's summary judgment motion, plaintiffs here made an analogous showing that Kodak's customers, the Kodak equipment owners, were "locked in" to Kodak equipment and the use of Kodak replacement parts by a similar economic investment. Such a "lock-in" both shows: (1) a relevant market in service for Kodak equipment because a Kodak equipment owner will not switch to an interbrand competitor because of a supracompetitive service price (see *Dimidowich v. Bell & Howell,*

803 F.2d 1473, 1481 n.3 (9th Cir. 1986), *and* (2) enhanced market power in the tying product, parts for Kodak machines, because a Kodak equipment owner cannot escape its requirement for such parts if it is economically "locked-in" to its Kodak machine. In showing this "lock-in" in the district court, plaintiffs were essentially "gilding the lily," proving their case was on all fours with *Digidyne*, right down to the "lock-in enhancement," when all they needed to do was show that triable issues of fact existed.

The district court totally misapprehended this "lock-in" argument of plaintiffs. It did not recognize that plaintiffs were arguing that they too had the same kind of "lock-in enhancement" recognized in *Digidyne*, but misconstrued their argument to be that the economic "lock-in" at bar somehow *created* or *constituted* the tying arrangement. Needless to say, the tying arrangement in this case was created by Kodak's expressed policy to refuse to sell its equipment owners parts if they purchased non-Kodak service or if they purchased brokered equipment without Kodak service. *Those* are the tying arrangements, wholly apart from any *Digidyne* lock-in enhancement.

In *Digidyne*, the defendant's tying arrangement was "enhanced" because its customers had incurred "substantial expense" in establishing systems that required defendant's tying product in order to operate. 734 F.2d at 1342. Because of the tying arrangement, the *Digidyne* customers had to purchase the tied product along with the tying product, even though they only desired the latter. Their investment of "substantial expense" in their systems, in the words of this Court, constituted a "lock-in" which

made it economically unfeasible to escape. A *Digidyne* customer could

> [F]ree itself from this "lock-in" only by abandoning its application software compatible with [the tying product,] defendant's RDOS, in which it has a substantial investment, or converting the software so that it may be used with another operating system. There was abundant testimony that conversion was not economically feasible.

Id. at 1342 (footnote omitted).

The situation at bar is identical. Kodak's customers have made a substantial investment in their Kodak equipment. The equipment is useless without the tying product, Kodak parts. While these customers can, *in theory*, abandon their Kodak equipment and replace it with that of a Kodak competitor, there was "abundant" evidence adduced by plaintiffs below on the motion for summary judgment that such "conversion" is "not economically feasible." (Record, Docket No. 40, Hernandez Dec. ¶ 56; Arnold Dec. ¶¶ 6-7; Varing Dec. ¶¶ 16-20.)

Apparently because it did not recognize Kodak's tying arrangement for what it was, the district court mistakenly thought plaintiffs were attempting to *establish* a tying arrangement *by means of* a "lock-in" argument. Perhaps this explains the court's curious statement,

> The case [*Digidyne*] has nothing to do with the present situation in which customers who have purchased Kodak equipment in a competitive market will tend to retain that equipment for its economic life.

(Excerpts, p. 70, ll. 3-7.)

Indeed, that statement is completely opposite to *defendant Kodak's own declarations* on summary judgment. Kodak implausibly swore that Kodak equipment owners will *not* retain their equipment for its economic life but rather will instantly rip out their installations and purchase competing equipment the minute Kodak tries to extract a supracompetitive price on its service which is admittedly tied to its parts. "Our [Kodak's] customers would simply switch to other equipment makers" if Kodak were to charge "monopolistic levels" on its "service prices." (Excerpts, p. 23, ll. 20-24.) Plaintiffs wholeheartedly agree with the district court's finding that Kodak equipment owners will tend to retain that equipment for its economic life, because this finding buttresses rather than undermines plaintiffs' "lock-in" enhancement argument.

That finding will assist plaintiffs' case upon remand. Under the reasoning of *Digidyne*, Kodak's power to coerce its equipment owners is enhanced by the "lock-in" comprised of their sunken costs in Kodak equipment.

ii. Development Cost Recoupment Does Not Justify Kodak's Tie.

Kodak argued below, and will doubtless argue here, the spurious proposition that it is required to tie its service to its parts (or "bundle" them, in industry jargon) in order to recoup the costs of parts development. Not even the district court accepted this bogus defense, for as this Court reiterated in *Digidyne*:

> The district court properly rejected defendant's argument, vigorously renewed in this court,

> "that it must bundle its software together with its CPUs in order to recover its substantial investment in software research and development," (490 F.Supp. at 1121), and that "it would be unfair to permit emulator-CPU manufacturers to reap the benefits of [defendant's] software [research and development] when they sell their competing CPUs for use with [defendant's] software." 490 F.Supp. at 1121-22.
>
> . . . Rather than sell the software separately at a price that would reflect research and development, defendant chose to restrict availability to its own CPU customers, thus restricting competition for the tied product. As the district court said, *"Recovery of investment costs has been explicitly excluded from the narrowly-construed exceptions to the per se rule against tie-ins." Id.* at 1122. . . .
>
> . . . In short, defendant must recover the cost of RDOS development by pricing RDOS appropriately, not by tying it to a separate product.

734 F.2d at 1343-44 (emphasis supplied).

Indeed, plaintiffs below offered *unrebutted* evidence that Kodak was *already* selling replacement parts to ISOs at prices *double* that charged its equipment owners who pay on a time and materials basis before it instituted its tying arrangement which completely cut off Kodak equipment owners who utilized ISO service. (Record, Docket No. 40, Dec. Tamvacakis ¶ 19; Dec. Welch ¶ 20.) Presumably, this 100% surcharge more than recompensed Kodak for its R&D costs, and at a minimum raises a triable issue of fact. Kodak's conceded ability to recoup its R&D costs through its parts pricing structure makes Kodak's institution of its tying arrangement all the more

egregious, and demonstrates Kodak's pristinely anticompetitive motive.

iii. Customer Choice Does Not Justify Kodak's Tie.

Lastly, Kodak argued, and the court below noted, that Kodak can sell parts to whomever it wants. The *Dimidowich* district court reasoned that "logical application" of distributor-termination cases such as *Bushie v. Stenocord Corp.*, 460 F.2d 116 (9th Cir. 1972) leads to the conclusion that a "manufacturer can, in effect, choose itself as the sole distributor of its own goods consistent with these [two] principles [legal choice of customers and development of distributorship systems], *absent impermissible methods and effects.*" *Dimidowich, supra,* 590 F. Supp. at 50 n.7 (emphasis supplied). Illegal tying arrangements are "impermissible methods." Thus, although Kodak, as sole distributor of its own parts, might not run afoul of Sherman Act Section 1 merely by "choosing" its own customers, Kodak *does* violate that law if, in "choosing" its parts customers, it forces those customers also to buy its service by means of an "impermissible method," such as its tying arrangements. Any ability of Kodak legally to refuse to deal with ISOs does not insulate it from liability for illegally tying its service to its parts.

c. Relevant Markets Exist in Parts and Service, and Kodak's Tying Arrangement Affects A Substantial Volume of Service.

The third element of a *per se* tying arrangement is a showing of "an effect upon a substantial amount of commerce in the tied product." *Digidyne, supra,* 734 F.2d at 1338. An examination of this element involves an inquiry into the market for the tied product. Curiously, the district court nowhere in the portion of its discussion of plaintiffs' Section 1 claims, including the tying claims, addressed the market issue. Only in its discussion of plaintiffs' Section 2 claims did it consider the question:

> Plaintiffs contend that Kodak has a dominant share of a purported market for servicing Kodak copiers and micrographic equipment. Assuming without deciding that such a market can be found to exist and that Kodak has market power in it, plaintiffs have not come forward with any facts to suggest that Kodak has attempted to leverage power in that market to gain competitive advantage in another market.

(Excerpts, p. 70, ll. 20-26)

Because it did not grasp Kodak's tying arrangement, the district court did not recognize that it is Kodak's power in the *parts* market which it is "leveraging" to gain competitive advantage in the *service* market. However, the lower court's "assumption" that Kodak has a dominant share of the market for servicing Kodak equipment is, in fact, consistent with this Court's *Digidyne* reasoning:

> More basically, the [district] court was misled by its conception that power throughout the product market for the tying product was required.
>
> * * *
>
> As the authorities cited earlier establish, the focus of the prohibition against tying arrangements is quite different. The concern is *not with the restraint on competition in the tying product but on competition in the market for the tied product.*

> What is required is not monopoly power in the tying product market, but only sufficient power to enable the seller to restrict competition in the tied product. If a seller's product is distinctive, not available from other sources, and sufficiently attractive *to some buyers* to enable the seller by tying arrangements to foreclose a part of the market for a tied product, *the adverse impact on competition in the tied product is not diminished by the fact that other sellers may be selling products similar to the tying product.*

734 F.2d at 1344-45 (emphasis supplied).

In its summary judgment motion, Kodak repeatedly argued that "interbrand competition" in copier and micrographic equipment at the point of sale somehow results in competition in the market for replacement parts for each brand of machine. Kodak asserts that because there is much competition in the market for machines, there is implictly competition in the market for parts; therefore, Kodak has no market power in the parts market, and, as a result, its tying arrangement is not illegal. This does not follow. Putting aside its customers' economic lock-in, which destroys Kodak's "competition for machines therefore competition for parts" non-sequitur, *Digidyne* teaches that, in a tying case, the focus is not restraint of competition in the *tying*-product market (parts), but in the *tied*-product market (service). And with respect to *that* market,

> [A] detailed analysis of competitive conditions in the tied product market is inappropriate in a *per se* case. Indeed as the district court held in its first opinion, *see*, 490 F.Supp. at 1116-17, all that is required in respect to the extent of the restraint in the market for the tied product is

> that a "substantial *volume* of commerce be foreclosed," *Jefferson Parish Hospital District No. 2 v. Hyde*, 104 S.Ct. at 1560 (emphasis added); and "substantial volume" in this context means only an amount greater than *de minimis*, a requirement clearly satisfied here. *See* 490 F.Supp at 1117.

Digidyne, supra, 734 F.2d at 1347.

Clearly, the "market for *servicing* Kodak copiers and micrographic equipment," assumed by the district court, is the relevant market in which to analyze restraint on competition for plaintiffs' tying claim, and this record contains abundant evidence to raise triable issues of fact regarding the existence of that market *and* Kodak's "foreclosure" of a "greater than *de minimis*" portion thereof by means of its tying arrangement. (*See* testimony of Kodak's own witnesses quoted at pp. 22-26 hereof, and of plaintiffs at pp. 16-17.)

Kodak's moving papers below carefully avoided any assertion as to whether its parts or service constituted distinct markets: "Kodak does not base this motion on the ground that a Kodak service market does not or cannot exist as a matter of fact or law." (Excerpts, p. 61, ll. 10-12.) Kodak's reluctance to address this issue is doubtless explained by the fact that cases Kodak itself cited show that parts and service markets can and do exist as matters of fact and law, particularly in situations such as here where Kodak has a natural monopoly. *Spectrofuge Corp. v. Beckman Instruments, Inc.*, 575 F.2d 256, 282 (5th Cir. 1978).

In *Spectrofuge*, defendant Beckman had a large share of the replacement parts market, but not even a natural monopoly therein: "[Plaintiff] Spectrofuge [an ISO] was

not dependent on Beckman for all parts; some – even major components – could be purchased from other sources." 575 F.2d at 271 (footnote omitted). Still, the court went on to analyze the existence of a service market and the conditions under which a relevant market should be limited to a single firm's products. The court first noted that:

> Since *du Pont* it has generally been recognized that every manufacturer has a "natural" monopoly in the sale and distribution of his own products, especially when they are sold under a trademark . . . Similarly, some courts in varying contexts have recognized that *a vertically integrated manufacturer* may initially have a "natural" monopoly over certain new products until other companies begin to compete with the manufacturer at one level of competitive activity.

575 F.2d at 282 (emphasis supplied).

Here, of course, Kodak has a "natural monopoly" over its own machines and parts sold under its trademark. Moreover, as a classic example of a vertically integrated manufacturer, Kodak currently continues to enjoy its natural monopoly over its parts because no others have yet begun to compete at that level. Under such circumstances, *Spectrofuge* teaches:

> Several cases indicate that it is possible under certain prescribed circumstances *to limit the relevant market to a single firm's products. E.g., Eastman Kodak v. Southern Photo Materials Co.*, 1927, 273 U.S. 359, 47 S.Ct. 400, 71 L.Ed. 684; *Poster Exchange, Inc. v. National Screen Serv. Corp.*, 5 Cir., 1970, 431 F.2d 334, 339; *Bushie, supra, Tire Sales Corp. v. Cities Serv. Oil Co.*, N.D. Ill. 1976, 410 F.Supp. 1222, 1230. Analysis of these cases

> reveals that *such a limited market would be appropriate when*, for example, *the vertically integrated manufacturer uses his dominant position at one level of competitive activity to eliminate competition at another level. . . .*

575 F.2d at 282 (emphasis supplied).

Such analysis is directly applicable here. Kodak, as a vertically integrated manufacturer, using its dominant position in the sale of its parts, in a market properly limited to Kodak parts, to eliminate competition at another level, service, where new entrants had already begun to compete before Kodak cut them off.

Dimidowich v. Bell & Howell, 590 F.Supp. 45 (C.D. Cal. 1984), *tying claim withdrawn on appeal*, 803 F.2d 1473 (9th Cir. 1986), did *not* involve replacement parts policies "virtually identical" to Kodak's here, as Kodak represented below and as the district court may have believed. In *Dimidowich*, defendant Bell & Howell maintained "a policy of not selling repalcement parts for its equipment except through its own service organization, *or directly to owner-users*." 803 F.2d at 1475 (emphasis supplied). Bell & Howell did *not condition* its sale of parts to owner-users on the latters' agreement *not* to purchase service from ISOs, as does Kodak, or on the condition the equipment be purchased directly from Bell & Howell, as does Kodak. Rather, the district court in *Dimidowich* expressly found that "*Bell & Howell's condition* for the sale of replacement parts for its equipment is *only* that the replacement parts be used on Bell & Howell equipment owned by the purchaser." 590 F.Supp. at 49 (emphasis added).

Thus, in *Dimidowich*, a Bell & Howell owner *could* order a part, hand in part to its ISO, and have that ISO

install the part and service its equipment. *A Kodak equipment owner cannot, because Kodak will not sell parts to its owners – even those who buy equipment directly from Kodak – if that owner purchases service from an ISO.* The parts policies of Kodak and of Bell & Howell in *Dimidowich* are fundamentally different: Bell & Howell did not tie parts to any other product; Kodak ties parts to an agreement that the parts buyer *not purchase service from an ISO* or that it *also buys Kodak service.* Because Kodak is the only other servicer in town, Kodak's policy in the first case, of course, in reality ties Kodak service to Kodak parts.

Finally, this Court's discussion in *Dimidowich* to the effect that service can constitute a separate product market, and that such a market can be limited to service for a single brand of equipment, assists plaintiffs in their tying claim and must be considered by the district court upon remand. In connection with a conspiracy claim, this Court in *Dimidowich* noted that:

> [A]n owner of broken B & H micrographic equipment is indifferent to people who can service Kodak or 3M machines. *If the owner's only option is to request service from B & H* or Comgraphix (depending on his location), *that is obviously the market the owner faces.* B & H is entitled to prove that replacement parts for different brands of micrographic equipment are interchangeable and therefore that its policy has no anticompetitive effect. However, if that is the case, its replacement parts policy makes little sense. In any event, B & H is not entitled to summary judgment on the ground that there is no evidence of anticompetitive effect.

803 F.2d at 1481 n.3 (emphasis supplied).

Here too, a Kodak customer's "only option is to request service from" Kodak, or roll up his sleeves and try to fix his directly purchased equipment himself. *That is obviously the market the Kodak owner faces,* precisely as in *Dimidowich.* That is "obviously" the relevant market for the tied product, service, here. That is "obviously" the market in which Kodak restrains competition because of its tying arrangement. Plaintiffs here have not merely met the *Jefferson Parish* "more than *de minimis*" test of restraint on competition in the tied service market, they have shown Kodak's ability to choke off *all* competition in that market by refusing parts sales to ISO-serviced equipment owners, to owner-ISOs, and to brokered-equipment owners. On this record, in the words of *Dimidowich,* Kodak "is not entitled to summary judgment on the ground that there is no evidence of anticompetitive effect."

Kodak's motion for summary judgment as to plaintiffs' tying claim was improvidently granted, and the district court must be reversed.

II. KODAK'S CHANGE OF ITS LONG-STANDING POLICY TO SELL PARTS TO COMPETITORS "UNNECESSARILY EXCLUDES OR HANDICAPS THEM" AND IS ILLEGAL UNDER *ASPEN* AND SECTION 2 OF THE SHERMAN ACT.

A. *Aspen* Controls the Claims Under Section 2 of the Sherman Act.

The district court summarily dismissed plaintiffs' claims under Section 2 of the Sherman Act, and the

Supreme Court decision in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985), without discussion of why *Aspen* does not apply. The district Court stated:

> Kodak has, of course, a natural monopoly over the market for parts it sells under its name but that imposes no duty on it to sell to plaintiffs. *See Olympia Equip. Leasing v. Western Union Telegraph*, 797 F. 2d 370, 375 (7th Cir. 1986) ("a firm with lawful monopoly power has no general duty to help its competitors.") *Compare Aspen Skiing Co. v. Aspen Highlands Skiing Corp., supra* (dominant seller monopolized market by terminating joint arrangement with competitor). Kodak's unilateral refusal to sell its parts to plaintiffs does not violate Section 2. *Bushie*, 460 F. 2d at 120.

(Excerpts, p. 71, ll. 1-10.)

The Supreme Court in *Aspen* recognized that a change by a monopolist of a long-standing policy which "unnecessarily excludes or handicaps competitors" violates Section 2 of the Sherman Act (15 U.S.C. § 2). The principles enunciated in the Supreme Court's unanimous decision in *Aspen* govern the present case.

In *Aspen* the defendant controlled three of four mountains and the ski lifts on them in Aspen, Colorado. He had a "natural monopoly" with respect to those mountains and lifts. The defendant had cooperated for several years with the plaintiff who controlled the fourth mountain and the lifts on it by jointly offering a multi-day "all Aspen" ski lift ticket. Skiers found the combination "all-Aspen" ticket so desirable that it consistently outsold all other offerings by defendant or plaintiff, including defendant's ticket which featured only its own

mountains. Beginning approximately in 1977, defendant began to take various actions that made it extremely difficult for plaintiff to compete, including refusal to continue to offer its mountains and lifts for the "all-Aspen" ticket. Plaintiffs market share declined steadily. Plaintiff sued, alleging that defendant had monopolized the Aspen downhill skiing market in violation of Section 2 of the Sherman Act. The jury found for plaintiff. The trial court entered judgment accordingly, and the Tenth Circuit Court of Appeals affirmed. A unanimous Supreme Court also affirmed, concluding:

> Thus the evidence supports an inference that [defendant] was not motivated by efficiency concerns and that it was willing to sacrifice short-run benefits and consumer good will in exchange for a perceived long-run impact on its smaller rival.

472 U.S. at 610-611.

In its opinion, the Supreme Court recognized that a firm with monopoly power *ordinarily* has no duty to cooperate with its competitors and may refuse to deal with them if that refusal is based on valid business reasons. 472 U.S. 596. Thus a monopolist may reject a novel offer to participate in a cooperative venture proposed by a competitor. 472 U.S. at 603.

The Court went on to hold, however, that a monopolist may not discontinue long-standing cooperative policies which are important to the character of a market in a deliberate effort to discourage customers from doing business with its smaller competitors. 472 U.S. at 604 and 610. Such "an important change in the character of the

market" (*Id.*) by a monopolist is subject to close scrutiny under the antitrust laws because:

> [i]n any business, patterns of distribution develop over time; these may reasonably be thought to be more efficient than alternative patterns of distribution that do not develop. The patterns that do develop and persist we may call the optimal patterns. By disturbing optimal distribution patterns one rival can impose costs upon another, that is, force the other to accept higher costs.

Id., 472 U.S. at 604, n.31, *quoting* Judge Robert Bork, *The Anti-Trust Paradox* (1978), p. 156.

B. *Bushie* and *Calculators Hawaii* are Inapposite.

Since the case at bar: (1) deals with a "pattern of distribution" that is nationwide, and not merely the termination or substitution of a single distributor; and (2) it does not involve "interbrand" competition by different equipment manufacturers for new equipment purchases, Kodak's reliance, and the district court's citation of *Bushie v. Stenocord Corporation*, 460 F.2d 116 (9th Cir. 1972) (single dealer termination in the Phoenix, Arizona area, based on decision of manufacturer to institute exclusive direct sales and service), and of *Calculators Hawaii, Inc. v. Brandt, Inc.*, 724 F. 2d 1332 (1983) (manufacturer adopts direct sales and service policy in Hawaii that was its usual practice nationwide) are totally inapposite.

In both *Bushie* and *Calculators Hawaii*, the Ninth Circuit was dealing with *sales of new equipment* as well as service for that equipment. With regard to sales of new

equipment, it is clear that interbrand competition forecloses a Section 2 monopolization claim for such sales. With regard to *service*, however, the Ninth Circuit in *Dimidowich* rejected Kodak's present claim that interbrand competition was relevant, stating:

> . . . an owner of broken B & H micrographic equipment is indifferent to people who can service Kodak or 3M machines. If the owner's only option is to request service from B & H or Comgraphix . . . that is obviously the market the owner faces.

803 F.2d at 1480-1481 n.3.

Whether interbrand competition forecloses a Section 2 monopolization claim for *service* was also answered by *Dimidowich*, since in the above-quoted passage, the Ninth Circuit ruled out the option of an owner of broken equipment to sell or junk that equipment and avail himself of another brand – the "option" of interbrand competition on the machine level. At best, for Kodak, whether interbrand machine competition is a viable defense to monopolization of service is a disputed material fact. At worst, as a matter of law, an owner of a Kodak photocopy machine purchased for $75,000+ facing a $2,000 per year supracompetitive Kodak maintenance charge cannot practically consider selling his machine for under $5,000 to avail himself of some "interbrand" competitor.

While in the case of cheaper pieces of equipment like dictating machines (*Bushie*) or money-handling machines (*Calculators Hawaii*) the cost of the machine versus the cost of supracompetitive service may practically allow switching to an interbrand competitor, here (and in *Digidyne*) the investment in the equipment is substantial, the

losses in switching are substantial, and owners are "locked-in." As recognized by *Dimidowich*, "the owner's only option" is to request service from whomever services his brand of equipment. Kodak's life-or-death reliance on "interbrand competition"[4] and the district court's adoption of that argument is a red herring.

C. Olympia Equip. Leasing Co. Recognizes a Monopolist's Obligation Sell to a Competitor.

The district court was likewise incorrect in its reliance on the Seventh Circuit case of *Olympia Equip. Leasing Co. v. Western Union Telegraph*, 797 F.2d 370 (7th Cir. 1986). *Olympia* involved an alleged monopolist's undisputed efforts to relinquish its monopoly in the relevant market. This was found to be an unassailable justification for its discontinuance of prior policies. Western Union had a monopoly in telex service and had also provided its customers with telex terminal equipment. It decided to withdraw from the equipment market and sell off that equipment. It also provided its salesmen with a list of independent terminal equipment suppliers including Olympia. When its own equipment did not sell fast

[4] *See, e.g.*, Plaintiff's Memorandum of Points and Authorities, "Denying the existence of interbrand equipment competition is thus critical to plaintiffs' case because without that foundation, Kodak admittedly has no power to leverage" and "fundamentally, the issue in this case is one of law whether an equipment manufacturer that lacks market power in the relevant equipment market may choose not to sell replacement parts to independent service firms." (Record, Docket No. 19, p. 7, ll. 23-25 and p. 21, ll. 13-17.)

enough, Western Union withdrew its sales force's assistance to Olympia. Olympia, which had no sales force, sued. The Seventh Circuit found Olympia could have hired its own sales force, and Western Union was not compelled to act as Olympia's sales agent. *Olympia* is thus distinguished on its basic facts.

Olympia, moreover, is distinguished expressly from cases like the one at bar, where the monopolist's acts injure a *competitor* who is also a *customer*. The court in *Olympia*, unlike the district court in this case, recognized that where there is a situation of a "monopoly supplier's discriminating against a customer because the customer has decided to compete with it," the case is an "essential facility" case like *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973) and the monopolist may be guilty of monopolization if it refuses to allow the competitor access to the facility. The court in *Olympia* reasoned:

> Some cases hold, however, that a firm which controls a facility essential to its competitors may be guilty of monopolization if it refuses to allow them access to the facility. *We accept the authority of these cases absolutely*. They are well illustrated by *Otter Tail Power Co. v. United States*, . . . It might seem that if a monopolist's refusal to sell his products or services to a competitor can thus be actionable under antitrust law, it must mean that monopolists sometimes do have a duty to help their competitors and that the cases which deny this proposition are wrong. But the monopolistic-refusal-to-deal cases qualify rather than refute the no-duty-to-help-competitors cases. If a *competitor* is also a *customer* his relationship to the monopolist is not only a competitive one. *The monopoly supplier who retaliates against customers who have the*

temerity to compete with him, by cutting such customers off, is severing a collateral relationship in order to discourage competition.

> The present case *would be an essential facility case* if Western Union had refused to supply telex service to a customer who got his terminal equipment from Olympia [a competitor] rather than from it, . . .

(*Id.* at 376, emphasis supplied).

The analogy is clear. Kodak is refusing to supply parts to ISOs because the ISOs have had the "temerity to compete" with it. Kodak also has refused to supply parts to anyone who purchases service from a competing ISO and not from Kodak, or who purchases his equipment from a competing broker. This case is more that a no-duty-to-help-competitors case. *This* is an "essential facility" case, and Kodak can be shown at trial to be guilty of monopolization for its monopolistic-refusal-to-deal.

Insofar as the district court read *Olympia* to advocate that monoplists are free to compete just like any other business, it was simply wrong. Judge Learned Hand rejected that view over forty years ago in his landmark opinion in *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945), and limited the actions of a monopolist. The Supreme Court further defined those limitations in *Aspen*.

D. The Ninth Circuit Has Also Recognized A Monopolist's Obligations to Sell to A Competitor

The Ninth Circuit has, as well, set out the limitations on a monopolist's refusal to deal recently in *Oahu Gas*

Service, Inc. v. Pacific Resources, Inc., 838 F. 2d 360 (9th Cir. 1988). This Court stated in *Oahu*:

> We therefore reject [defendant] Pacific Resources' broad contention that the antitrust laws may never impose duties on a monopolist to aid its competitors. Because of a monopolist's special position the antitrust laws impose what may be characterized as affirmative duties [citing *Aspen* where the "monopoly power was required to continue a marketing arrangement with its small neighbor" when the monopolist had no legitimate business justification for refusal to deal, and dealing with his competitor "increased competition and benefited consumers"]. These duties are not absolute, however; they arise only when there is no justification for refusing to aid a competitor.
>
> Where a monopolist's refusal to aid a competitor is based partially on a desire to restrict competition, we determine antitrust liability by asking whether there was a legitimate business justification for the monopolist's conduct.

(*Id.* at 368.)

In *Oahu*, this Court eventually found that Pacific Resources was not obliged to *expand* its refinery *to provide* for production of propane that it *did not produce* at the time, propane that could be purchased by Pacific Resources' competitor Oahu. Pacific Resources' decision, based on the fact that expansion would be *unprofitable*, was found not to violate Section 2. The facts of *Oahu* clearly distinguish it from the case at bar.

In a case more on point, *Pacific Coast Agricultural Export Ass'n. v. Sunkist Growers, Inc.*, 526 F.2d 1196 (9th Cir. 1975), *cert. denied*, 425 U.S. 959 (1976), this Court

found a Section 2 violation where Sunkist, with monopoly power over the supply oranges, refused to sell oranges to a competitor who exported oranges. Just as Kodak in this case has used its control over the wholesale supply of parts to control retail service of Kodak machines, Sunkist had cut-off plaintiff's already-existing supply of oranges in order to eliminate its competitor at the retail level. This Court found that "Sunkist's control of supply was employed to extend is monopoly illegally into distribution." *Id.* at 1204.

E. <u>The Standard To Be Applied</u>.

Taking the holdings in *Aspen, Pacific Coast Agricultural Export Ass'n.* and *Oahu*, the pertinent legal inquiry in the present case, as to violation of Section 2 of the Sherman Act, is: Was Kodak's radical change in parts policy in refusing to sell parts to its ISO *customers* an unnecessary exclusion and handicapping of its *competitors* in another area, that of service, or was it primarily motivated by a valid business justification? If it was the former, it was illegal and predatory. If it was the latter, it was lawful. Both present material issues of fact, and, neither is properly decided by summary judgment.

Plaintiffs submitted substantial evidence which supports a finding, or which at least raises a triable material issue of fact, as to whether Kodak's actions in cutting off parts were unnecessarily exclusionary and predatory or were justified by legitimate business interests. (*See* Statement of Facts III.E. and III.F., *supra*.) Kodak itself has, by implication, listed elimination of plaintiff ISOs as a reason for its policies. (See record, Docket No. 19, pp. 17,

l. 3-18 l. 2, eliminating "free-riders," and pp. 14, ll. 14-15, l. 6, preventing ISOs from doing Kodak service and "dividing responsibility for product reliability.") Kodak's other proferred reason, to reduce inventories and increase profits on parts, likewise failed. Kodak had always stocked its parts to supply parts for its entire population of Kodak equipment. It will continue to do so under its new policy. Parts sold in the past to ISOs were sold at great profit to Kodak. Kodak was willing to sell parts to anyone else but ISOs – its competitors. (*See* Statement of Facts III.E., *supra*.)

Kodak's own statements and its timing of the parts cutoff, both to individual ISOs like ITS and Top Copy/ Legal Copy, and as to the market generally (as the ISOs began to erode its market share), do not show simple business-justified motives, but the motives a predatory competitor. Kodak, in the words of *Olympia* "retaliat[ed] against customers who had the temerity to compete with [it], by cutting such customers off." They were, plainly and simply, "severing a collateral relationship in order to discourage competition."

Kodak's actions are illegal under Section 2 of the Sherman Act, and plaintiffs have raised triable issues of material fact as to such illegality.

<u>CONCLUSION: RELIEF SOUGHT</u>

The district court's judgment against plaintiffs should be reversed as to both the tying claims under Section 1 of the Sherman Act, and the monopolization claims under Section 2 of the Sherman Act. There should

be a finding that plaintiffs have raised triable issues of material fact as to:

1. Whether relevant markets for parts and service of Kodak equipment exist;

2. Whether Kodak has market power in the parts market;

3. Whether Kodak's tying arrangements constitute *per se* violations of Section 1 of the Sherman Act or unreasonably restrain competition in the service market; and

4. Whether Kodak monopolized the service market by changing its longstanding parts policies as an unnecessary and deliberate effort to exclude competitors.

STATEMENT OF RELATED CASES

Plaintiffs are aware of no other cases in this Court that are related to this case within the meaning of Ninth Circuit Rule 28-2.6.

Dated: October 10, 1988

Respectfully submitted,

By: /s/ James A. Hennefer
JAMES A. HENNEFER

Attorney for Plaintiffs-Appellants

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

NO. 88-2686

IMAGE TECHNICAL SERVICES, INC., et al.,
Plaintiffs-Appellants,

v.

EASTMAN KODAK COMPANY,
Defendant-Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA
Case No. C-87-1686-WWS

Honorable William W. Schwarzer
Judge Presiding

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CERTIFICATE AS TO INTERESTED PARTIES

Pursuant to Ninth Circuit Rule 28-2.1, counsel for appellee Eastman Kodak Company certifies that there are no known interested parties other than the parties participating is this case.

These representations are made to enable judges of the Court to evaluate possible recusal.

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INTRODUCTION

On three occasions in the past sixteen years, the Ninth Circuit has ruled that a manufacturer, who lacks market power and acts unilaterally, may decline to sell to anyone replacement parts for its own branded products without violating the Sherman Act. *Dimidowich v. Bell & Howell*, 803 F.2d 1473 (9th Cir. 1986), *modified*, 810 F.2d 1517 (1987); *Calculators Hawaii, Inc. v. Brandt, Inc.*, 724 F.2d 1332 (9th Cir. 1983); *Bushie v. Stenocord Corp.*, 460 F.2d 116 (9th Cir. 1972). No Ninth Circuit case has ever held to the contrary. In fact, other circuit and district courts addressing the issue have upheld this practice against antitrust challenge. *See e.g., Spectrofuge Corp. v. Beckman Industries, Inc.*, 575 F.2d 256 (5th Cir. 1978), *cert. denied*, 440 U.S. 939 (1979); *Nobel Scientific Industries, Inc. v. Beckman Industries, Inc.*, 5 Trade Reg. Rep. (CCH) ¶ 67,809 (4th Cir. 1987), *aff'g and adopting*, 670 F. Supp. 1313 (D. Md. 1986).

Appellants' position, at bottom, would require this Court to overturn all of these decisions. Appellants would compel Kodak, one of many firms in the fiercely competitive copier and micrographics industries, to support "freeriding" by appellants. They would force Kodak to promote competition against itself by providing appellants and other "Independent Service Organizations" ("ISOs") with replacement parts they would use to compete *only* against Kodak. To support this claim, they try to twist an undisputed set of facts into numerous types of Sherman Act violations. However, as the District Court recognized, there is but one fundamental issue in this case: do the antitrust laws impose a duty on a manufacturer who lacks market power to sell replacement parts to

ISOs so that they may compete more easily against the manufacturer's own service organization?

The antitrust laws impose no such duty, and because they do not the District Court was correct in granting Kodak summary judgment.

I. QUESTION PRESENTED

Kodak manufactures and markets copiers and micrographics equipment. It competes against many firms and concededly lacks market power. Kodak also makes or procures replacement parts for its products and uses such parts in providing maintenance and repair service to its customers. Kodak does not knowingly sell replacement parts for its copiers nor for many of its micrographics products to ISOs like appellants. Did the District Court correctly grant summary judgment on appellants' claims that Kodak violated Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1 & 2, where there was no genuine issue of material fact that (a) Kodak adopted that policy unilaterally, (b) the policy did not unreasonably restrain trade or threaten monopoly in any relevant market, and (c) that Kodak had valid, pro-competitive business reasons for its policy?

II. STATEMENT OF THE CASE

A. Jurisdiction and Timeliness.

Kodak agrees with appellants' statements concerning jurisdiction and timeliness.

B. Proceedings Below.

Plaintiffs filed their 47-page complaint in April 1987. (Record, No. 1) They alleged 16 "Claims for Relief." Four are brought pursuant to the federal antitrust laws. The remaining twelve claims are brought pursuant to various state unfair competition statutes or under the common law of unfair competition. The antitrust claims include several allegations of conspiracy, several tying arrangements, and several theories of monopolization. However, the gravamen of all claims is that Kodak has a duty to sell plaintiffs replacement parts so they may compete more easily against Kodak in the provision of repair and maintenance service on Kodak equipment.

Kodak denied all the allegations of wrongdoing contained in the complaint and asserted various affirmative defenses. (Record, No. 3) For several months the plaintiffs took no action to advance the case. In August 1987, Kodak filed its motion for summary judgment. (Record, No. 11) Kodak explained that it had filed the motion before plaintiffs had initiated discovery because the key fact — Kodak's unwillingness to sell parts to ISOs like the plaintiffs — was not disputed. (Record, No. 19, p. 2) That was Kodak's policy, and the question was whether the antitrust laws forbade it.

Kodak did not, however, oppose plaintiffs' subsequent request for discovery. At a status conference held on September 11, 1987, Kodak agreed that plaintiffs were entitled to discovery limited to the issues material to Kodak's motion, and in fact plaintiffs were given and took the opportunity to propound interrogatories, obtain documents and take depositions. (Record, No. 27, Order

of Sept. 18, 1987) On December 21, 1987, the District Court held another status conference during which it heard, and granted in part, plaintiffs' request for additional discovery. The court's order also provided that plaintiffs should respond to Kodak's motion on January 29, 1988 — five months after it was filed — and that plaintiffs could, if they wanted, request still further discovery in their brief pursuant to F.R.Civ.P. 56(f). (Record, No. 36, Order of Jan. 4, 1988.)

Plaintiffs advanced fewer theories in their opposition papers than had been in the complaint, and fewer still were supported by any evidence. The theories most seriously advanced were: (a) that Kodak had used its parts policy to monopolize relevant markets defined as the service of Kodak micrographics equipment and copiers; (b) that Kodak had engaged in unlawful tying by using its control over parts to force customers to buy Kodak equipment and Kodak service; and (c) that Kodak had convinced its own parts suppliers not to sell parts to plaintiffs.

By Memorandum of Opinion and Order dated April 15, 1988, the District Court granted Kodak's motion and dismissed the complaint. (Record, No. 49, Order of April 18, 1988) Plaintiffs' Section 1 claims were dismissed because the court found that plaintiffs had failed completely to support their conspiracy allegations with any evidence. In particular, the court found that the only evidence of the alleged agreements between Kodak and its parts suppliers was inadmissible hearsay, and that such an agreement, if it in fact existed, would not have violated Section 1 anyway. (*Id.* at 4) The court also found

that plaintiffs had failed to raise a genuine issue regarding the existence of any unlawful tying arrangements. No evidence had been presented by plaintiffs that Kodak had conditioned parts sales on a customer's agreement to purchase either additional equipment or Kodak service. (*Id.* at 4-5) Finally, the court dismissed plaintiffs' Section 2 claims because Kodak concededly lacked market power in the relevant interbrand equipment markets and because any "natural monopoly" which Kodak had over its own branded parts did not impose on it a duty to help its competitors. (*Id.* at 7-8) Judgment for Kodak was entered on April 19, 1987. (Record, No. 50)

III. STATEMENT OF FACTS

Plaintiffs have attempted to create the impression that there are disputed factual issues by presenting a lengthy and complicated statement of facts. The *material* facts are simple, however, and they are not genuinely disputed.

A. The Parties and the Market Setting.

The eighteen plaintiffs are engaged in the business of repairing and servicing Kodak copiers and micrographics equipment. (Record, No. 1, Complaint ¶ 21) Generally they do not manufacture the replacement parts which they use to service that equipment. Rather, they claim a right to purchase parts, which they broadly define to include tools, test equipment, supplies, and service manuals, from the only company which they identify as their competitor, Kodak. (*Id.*, ¶ 22)

Kodak's Copy Products Division manufactures, markets and services a line of copier-duplicators sold under the trademark "Ektaprint." (Record, No. 14, Murray Decl. ¶ 1) Kodak's Business Imaging Systems Division ("BISD") manufacturers, markets and services business micrographics equipment, principally microfilmers, reader-printers, and other microfilm retrieval systems. (Record, No. 15, Lacy Decl. ¶ 3)

Kodak's Ektaprint copiers perform the same photocopy function as and compete directly with copiers manufactured by a long list of major firms, including Xerox, the industry giant, and Japanese firms such as Savin, Canon, Ricoh and Minolta. Plaintiffs concede that Kodak does not have any market power in the copier market. (Appellants' Opening Brief ("A.O.B."), pp. 44-45)

Plaintiffs also concede that Kodak has no market power in any micrographics equipment market. (*Id.*) Kodak faces strong competition from micrographics equipment makers such as Canon, Minolta, 3M and Bell & Howell. Kodak's share of U.S. sales of business micrographics equipment is less than 20 percent. (Record, No. 15, Lacy Decl. ¶ 6) Moreover, customers have alternatives other than microfilm — such as hard copies or computer storage — to manage information in image form. (*Id.*, ¶¶ 5, 14-15) Thus, any attempt by any micrographics equipment maker to exercise market power would fail.

At the present time, Kodak and its parts suppliers are the only firms which manufacture replacement parts for Kodak's copiers and micrographics products. (Record, No. 1, ¶ 23) Plaintiffs offered no evidence suggesting that

they were incapable of making such parts, as independent firms, for example, have manufactured parts for different makes of computers. Plaintiffs simply prefer that Kodak act as their parts supplier. Of course, by obtaining those parts, plaintiffs compete only against Kodak.

B. Kodak's Parts Policies

Kodak's Copy Products Division and BISD have slightly different parts policies. They are described separately.

1. The Copy Products Parts Policy

Ever since Kodak entered the copier business in 1975, the business practice of its Copy Products Division has been to sell parts for its copiers only to direct copier customers. Kodak does not knowingly sell parts to ISOs or other persons engaged in servicing Kodak copiers owned by others, or to persons who wish to service Kodak copiers they have purchased from sources other than Kodak. (Record, No. 14, Murray Decl. ¶ 23) Kodak has never knowingly sold copier parts to anyone who would use those parts to service someone else's Kodak copier. (*Id.*)

2. The BISD Parts Policy.

The BISD parts policy is somewhat different. The relevant business practice was adopted by Kodak in April 1985, and distinguishes between "new products" and

"older products" as of that date Historically, Kodak sold micrographic equipment parts to anyone, including plaintiffs. When Kodak changed its policy in 1985. it "grandfathered" older product parts. Kodak continues to sell such parts to anyone, including plaintiffs. (Record, No. 15, Lacy Decl. ¶ 22; No. 12, Lorensen Decl. ¶ 4) However, if there is a shortage of a part, orders from ISOs are filled only after the needs of Kodak and its direct equipment customers have been met. (Record, No. 12, Lorensen Decl. ¶ 6) In addition, certain "all time" parts — parts as to which Kodak has placed a final order with its supplier intended to last for the life of the equipment and which cannot be ordered again -- are often saved for Kodak's customers and are not sold to ISOs. (Id., ¶ 10) With respect to newer product parts (beginning with the KODAK RELIANT Intelligent Microfilmer 1000), BISD adopted the Copy Products parts policy: parts for new products are made available only to direct equipment customers. (Record, No. 15, Lacy Decl. ¶ 22)

C. The Business Reasons For Kodak's Parts Policies.

As the undisputed evidence below demonstrated, there are three main reasons for the parts policies: (1) to promote interbrand equipment competition by allowing Kodak to stress its renowned service commitment; (2) to reduce Kodak's inventory costs by not stocking parts for ISOs; and (3) to prevent ISOs from freeriding on Kodak's investment in copier and micrographics equipments, parts, and service.

1. Promoting Interbrand Competition

Kodak's primary business is selling equipment, *i.e.*, copiers and micrographics equipment. Kodak also sells parts and service, but as an adjunct to equipment sales. Service keeps the equipment running and the customer satisfied. Good service enhances Kodak's ability to sell equipment. (Record, No. 14, Murray Decl. ¶ 13; No. 15, Lacy Decl. ¶¶ 11, 12)

It is undisputed that in marketing their products, both the Copy Products Division and BISD stress Kodak's commitment to outstanding service. Kodak's commitment to service is evidenced by the fact that surveys among both the copier and micrographics equipment users consistently rate Kodak service number one in customer satisfaction. Kodak heavily advertises that fact in marketing its copiers and micrographics equipment against its competitors. (Record, No. 14, Murray Decl. ¶ 19; No. 15, Lacy Decl. ¶ 20)

It is also undisputed that a manufacturer's commitment to service is a key factor in a customer's decision to choose one brand of equipment over another. Good factory service, therefore, is an inextricable part of a manufacturer's equipment product offering. This is also evidenced by Kodak's advertising. One Kodak campaign touts "The Kodak Advantage" — "leading technology, proven reliability and the best service in the business." (Record, No. 14, Murray Decl. ¶ 22 & Ex. 4)

The relationship of service to the underlying equipment offering was central to Kodak's decisions to adopt the challenged parts policies. The main reason that Kodak

adopted the copier parts policy when it started selling copiers in 1975 was to bolster its emphasis on quality service; that was a key part of its basic business strategy for marketing its copiers. (*Id.*, Murray Decl. ¶ 26) The same consideration influenced BISD's decision to adopt a modified parts policy in April 1985. (Record, No. 15, Lacy Decl. ¶ 25)

The parts policies have also been maintained because Kodak believes that dividing responsibility for product reliability between itself and an ISO damages Kodak's relationship with its equipment customers. This happens in two ways. First, when an ISO has displaced Kodak service with respect to a particular customer, Kodak loses the day to day contact with the customer that is crucial to keeping the customer satisfied and learning of potential new sales opportunities. (Record, No. 15, Lacy Decl. ¶ 27; No. 14, Murray Decl. ¶ 28) But even more important, divided responsibility inevitably leads to "finger-pointing" whenever an ISO is unable to repair a problem. Wanting to deflect the blame away from themselves, ISOs tend to blame Kodak for the problem, even if it is the result of improper diagnosis, maintenance or repair. (Record, No. 14, Murray Decl. ¶ 30; No. 15, Lacy Decl. ¶ 27) Kodak has no opportunity to respond; it may never even hear of the problem. But the customer's image of Kodak is tarnished and that hurts Kodak when the customer has future equipment needs. Kodak does not want to encourage even the possibility of that happening by fostering the efforts of ISOs.

Thus, Kodak's parts policies promote competition by increasing Kodak's competitiveness against its many domestic and Japanese equipment competitors.

2. Reducing Inventories

A second reason for the parts policies is to reduce Kodak's parts inventories and thereby reduce Kodak's costs. This was the main reason that Kodak changed its policy with respect to viewer micrographic parts. (Record, No. 15, Lacy Decl. ¶ 29; No. 13, Gross Decl. ¶ 6) In early 1985, Kodak had over $16 million of micrographic equipment parts in stock. (Record, No. 13, Gross Decl. ¶ 6) As a company-wide effort to improve its asset management, Kodak began looking for ways to reduce its parts inventory. One way was to stop making, buying and stocking parts for the benefit of ISOs. Kodak management felt it made no sense to subsidize the efforts of these firms by manufacturing or purchasing and, at Kodak's expense, maintaining inventories of parts for their use. (Record, No. 13, Gross Decl. ¶ 6; No. 15, Lacy Decl. ¶ 29) Thus it was decided not to sell parts for newer products to entities other than direct equipment customers. That way Kodak did not have to make, buy, or inventory additional parts.

3. Not Supporting Freeriding

A third reason for the parts policies is that Kodak does not want to help the ISOs take away service revenues from Kodak.

ISOs are what economists call freeriders. Unlike Kodak, which has invested hundreds of millions of dollars in its copier and micrographics equipment businesses, the ISOs have invested virtually nothing. (Record, No. 15, Lacy Decl. ¶ 28; No. 14, Murray Decl. ¶ 31) They

refuse to make their own parts or obtain them from other sources.

The reason ISOs target service revenues is obvious. If they can get parts from Kodak, ISOs can offer some level of service on a virtual shoestring. Their market is made for them by Kodak at Kodak's expense. And they can underprice Kodak because ISOs do not need to recapture the huge investment Kodak made in the business.

Kodak does not feel obligated to promote the activities of freeriders like plaintiffs, whose sole business is targeting revenues which otherwise would have been earned by Kodak. Because it must compete against the likes of Xerox, 3M, Bell and Howell and the ever increasing number of Japanese firms, it is challenge enough for Kodak to make an adequate return on its investments in these industries. (Record, No. 14, Murray Decl. ¶ 32) As freeriders, plaintiffs seek to force Kodak to assist them in their efforts to take away Kodak's service revenues, an important part of the total return on those investments. Accordingly, quite apart from all of the other reasons motivating the parts policy, Kodak has declined to sell parts to the ISOs because it does not want to help them take away revenues from Kodak. If the ISOs want to compete against Kodak, Kodak believes that they, like Xerox and 3M and Kodak's Japanese competitors, should develop the needed resources at their own risk and expense.

D. The Implementation of Kodak's Parts Policies

Plaintiffs try to make something of Kodak's efforts to enforce its parts policies, claiming that these efforts

evidence anticompetitive intent. (*See, e.g.*, A.O.B. at 11-14) Those "facts" add nothing. Kodak readily admits it has done as well as it could to enforce its policies and prevent ISOs' from surreptitiously buying parts from Kodak contrary to Kodak's policies. To do that Kodak obviously had to identify customers ineligible to buy certain parts; hence the efforts to identify "BENUs" ("Business Equipment Non-Users") about which plaintiffs complain. Kodak also had to counteract the various forms of subterfuge, *e.g.*, ordering parts under assumed names, that ISOs use to circumvent the parts policies. (*Id.* at 12) Admittedly, Kodak has been far less than 100% successful in enforcing its policies, and as a result many of the plaintiffs and other ISOs have been able to acquire parts from time to time or even regularly.

All of this, however, is beside the point. Any failures by Kodak to enforce the policy simply benefit plaintiffs and other ISOs. They surely do not give them more reason to complain than if Kodak succeeded in enforcing its policies with 100% effectiveness.

STANDARD OF REVIEW

Review of a grant of summary judgment is *de novo*. *Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1436 (9th Cir. 1987). Summary judgment is properly granted where the moving party shows that there is no genuine issue of material fact. "Only disputes over facts that might affect the outcome of the suit under governing law will properly preclude the entry of summary judgment." *Id.*

This Court has recently recognized that developments in the law have "increased the utility of summary

judgment." *California Architectural Building Products, Inc. v. Franciscan Ceramics, Inc.*, 818 F.2d 1466, 1468 (9th Cir. 1987), *cert. denied*, ___ U.S. ___, 108 S. Ct. 698 (1988).

> "First, . . . if the non-moving party will bear the burden of proof at trial as to an element essential to its case, and that party fails to make a showing sufficient to establish a genuine issue of fact with respect to the existence of that element, then summary judgment is appropriate. [cite omitted] Second, to withstand a motion for summary judgment, the non-moving party must show that there are 'genuine factual issues that can be resolved only by a finder of fact *because they may reasonably be resolved in favor of either party*.' [cite omitted] Finally, if the factual context makes the non-moving party's claim *implausible*, that party must come forward with more persuasive evidence than would otherwise be necessary to show that there is a genuine issue for trial."

Id. (emphasis by Court). Plaintiffs' challenge to Kodak's parts policies raises no genuine issues of material fact.

ARGUMENT

I. THE ANTITRUST LAWS DO NOT REQUIRE KODAK TO SELL PARTS TO APPELLANTS.

Plaintiffs advance two theories on appeal: (1) that Kodak's unilateral decision not to sell parts to ISOs constitutes an unlawful tying arrangement, and (2) that *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985) (*"Aspen"*), obligates Kodak to sell parts to competitors. Both arguments will be addressed fully. However, as the Ninth Circuit has already decided the

fundamental issue in this case on three occasions, it makes sense to start with those cases.

A. The Basic Rule Of *Bushie, Calculators Hawaii* and *Dimidowich*.

Nearly seventy years ago, the Supreme Court ruled in *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919), that the Sherman Act "does not restrict the long-recognized right of trader or manufacturer . . . freely to exercise his own independent discretion as to parties with whom he will deal." The Ninth Circuit has applied the *Colgate* doctrine to rule on three separate occasions that a manufacturer's unilateral refusal to sell replacement parts does not violate the antitrust laws. *Bushie v. Stenocord Corp.*, 460 F.2d 116 (9th Cir. 1972); *Calculators Hawaii, Inc. v. Brandt, Inc.*, 724 F.2d 1332 (9th Cir. 1983); *Dimidowich v. Bell & Howell*, 803 F.2d 1473 (9th Cir. 1986), *modified*, 810 F.2d 1517 (1987).

In *Bushie*, the plaintiff sold and serviced Stenocord dictating machines, under a distributorship agreement. Later, Stenocord elected to proceed exclusively with its own sales and service operation, and terminated Bushie's distributorship. Bushie claimed, *inter alia*, that he wished to continue selling and servicing Stenocord machines after his distributorship was terminated, but was unable to obtain the equipment and parts he needed to do so. He sued Stenocord and contended that by refusing to sell him equipment and parts Stenocord was trying to monopolize markets for the sale and servicing of Stenocord dictating machines. 460 F.2d at 118 n.1. In other words, plaintiff advanced the same basic claims of this

case. The Ninth Circuit affirmed a summary judgment for Stenocord, rejecting the plaintiff's arguments under both Section 1 and 2.

The key insight of *Bushie* is that if a manufacturer is faced with active interbrand equipment competition, it cannot restrain trade in or monopolize a "market" defined solely in terms of the sale or servicing of its own branded equipment. The Court recognized that, in a rough sense, every manufacturer "has a 'natural monopoly over his own products.' " *Id.* at 120, *quotinq Industrial Building Materials, Inc. v. Interchemical Corp.*, 437 F.2d 1336, 1344 (9th Cir. 1970). However, "[u]nless the manufacturer used his natural monopoly to gain control of the *relevant* market *in which his products compete*, the antitrust laws are not violated." *Id.* Thus, only if the plaintiff can establish an interbrand monopoly, in the court's words "total market dominance -- as distinguished from 'brand' monopoly," will a viable antitrust action lie. *Id.* Of course, plaintiffs here do not even claim that Kodak has interbrand market power. (A.O.B., pp. 44-45)

The same result was reached, although for different reasons, in *Calculators Hawaii.* Again, the issue was a manufacturer's refusal to sell replacement parts for its products. The defendant, Brandt, Inc., manufactured money-handling machines. For some years it marketed its products in Hawaii through a distributor which had contracted with the plaintiff, Calculators Hawaii, to service and repair Brandt's products. In this role, Calculators Hawaii purchased repair parts from Brandt. 724 F.2d at 1336.

In 1976 Brandt altered its distribution system by replacing its distributor with a sales agent. The agent was given the exclusive right to both sell and service Brandt's products in Hawaii, and, accordingly, Brandt thereafter refused to sell replacement parts to Calculators Hawaii. *Id.* Calculators Hawaii brought an antitrust action, and in a bench trial prevailed on its claim that the refusal to sell parts restrained trade in and monopolized a market for "Brandt parts." *Id.* at 1337-39.

The Ninth Circuit reversed, finding that Brandt's parts policy did not restrict competition, did not evidence an intent to monopolize, and was not predatory. *Id.* at 1338 (re Section 1 claims) & 1339 (re Section 2). The court analogized the parts policy to an exclusive dealing arrangement. Such an arrangement, by definition, contemplates refusals to deal with others, and as a consequence those others lose business. But, the court held, that "is simply insufficient" to prove either anticompetitive effect or intent. *Id.* at 1337.[1] Indeed, the court held that in the absence of proof of harm to competition -- an

[1] In fact, exclusive dealing arrangements are subject to antitrust scrutiny *only* for their potential effects on interbrand equipment competition. *Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2, 45 (1984) (O'Connor, J., concurring) ("Exclusive-dealing arrangements may, in some circumstances, create or extend market power of a supplier . . . and may thus restrain horizontal competition"). They are presumed not to harm competition when "other and equivalent brands of [the relevant product] are readily available in the market." *United States v. Arnold Schwinn & Co.*, 388 U.S. 365, 376 (1967), *overruled on other grounds in Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

"absolutely essential" element of the case — the manufacturer did not even need to advance valid business reasons for its policy in order to prevail. *Id.* at 1338.[2]

Finally, in *Dimidowich* the Ninth Circuit considered a parts policy that was nearly identical to Kodak's — the policy maintained by Kodak's competitor in the micrographics business, Bell & Howell ("B & H"). B & H's policy, like Kodak's, is to sell replacement parts for its micrographic equipment only through its own service organization or directly to owner-users. 803 F.2d at 1475. It will not sell parts for use by ISOs. *Id.* Dimidowich, an ISO like the plaintiffs here, challenged that policy as an anticompetitive refusal to deal, as a tying arrangement, and as the product of an illegal conspiracy. The District Court held that B & H was entitled to summary judgment under *Bushie*, reasoning that even if the policy "has the natural tendency to monopolize the servicing of B & H equipment," it does not monopolize a *relevant* market, *i.e.*, the market "in which [B & H's] products compete." 590 F. Supp. at 49-50. The District Court also found that B & H's

[2] Plaintiffs argue that *Bushie* and *Calculators Hawaii* do not apply, first, because this case is national in scope, and second, because they do not sell equipment. (A.O.B., p. 44) Those arguments go nowhere. The first argument is simply specious — that several farflung plaintiffs have decided to join together in a "national" lawsuit does not in any way affect Kodak's obligations under the antitrust laws. Plaintiffs' second argument is a mere smokescreen. The reality of interbrand equipment competition cannot be ignored simply because plaintiffs claim to offer only service. The tail does not wag the dog. Kodak has no obligation to support freeriding competitors, as this Court recognized in *Bushie, Calculators Hawaii,* and *Dimidowich*. Plaintiffs cannot escape the rule by ignoring the basis for it.

policy was not a tying arrangement and not the product of a conspiracy. *Id.*

The Ninth Circuit affirmed with respect to all the unilateral conduct claims. 803 F.2d at 1478. Regarding Dimidowich's refusal to deal claim, the Court observed that "[a] manufacturer may choose those with whom it wishes to deal and unilaterally may refuse to deal with a distributor or customer for business reasons without running afoul of the antitrust laws." *Id.* Moreover, with respect to the conspiracy claim, the Court reaffirmed *Bushie* and *Calculators Hawaii* by holding that even where the refusal to deal is the product of a vertical conspiracy, "[t]he defendant's assertion of legitimate business justifications for its behavior . . . will generally result in summary judgment." *Id.* at 1484.[3]

[3] The *Dimidowich* court reversed summary judgment regarding a "hybrid conspiracy" claim. That decision is of no moment here. B & H had allegedly conspired with its only distributor, Comgraphix, to foreclose plaintiff from obtaining parts. Comgraphix also competed with B & H, which concerned the Court since horizontal group boycotts are in some cases per se illegal. Because B & H and Comgraphix were both competitors and supplier/distributor, the Court held that Comgraphix had a peculiar "hybrid" relationship — they were both horizontal competitors and vertical supplier/ distributors. That very nearly made the alleged agreement between them *per se* illegal. *Id.* at 1484 ("[i]n the absence of a vertical component," agreement if proved would have been *per se* illegal). Kodak has no distributors whatever (Record, No. 14, Murray Decl. ¶ 24; No. 15, Lacy Decl. ¶ 3), and plaintiffs have dropped their "hybrid" conspiracy theory. Accordingly, this portion of *Dimidowich* is irrelevant to this case.

These decisions establish a clear and sensible rule of law. A firm facing interbrand equipment competition cannot monopolize — at least not in any anticompetitive sense — aftermarkets defined solely in terms of parts and service for its own brand equipment. Whether or not these are separate markets, they are at least related to the equipment market since, by hypothesis, all of the consumers in any "Kodak parts or service markets" are also Kodak *equipment* customers. As such, every customer in those "markets" has the ability to choose other equipment vendors (and their parts and service offerings) if Kodak tries to charge supracompetitive parts and service prices. Kodak knows this, and the undisputed evidence is that Kodak deliberately prices its service contracts to be competitive with its equipment competitors. (Record, No. 14, Murray Decl ¶ 11; No. 15, Lacy Decl. ¶ 9) In this way, interbrand equipment competition prevents Kodak or any similarly situated manufacturer from restraining competition or exerting market power in any aftermarket, including any hypothetical parts or service markets.

The Fourth Circuit recently relied on this analysis in ruling that refusals to sell parts or supplies to competitors do not violate the Sherman Act. *Nobel Scientific Industries, Inc. v. Beckman Industries, Inc.*, 831 F.2d 537 (4th Cir. 1987), *aff'g and adopting*, 670 F. Supp. 1313 (D. Md. 1986), *cert. denied*, 108 S. Ct. 2886 (1988). There, defendant Beckman was charged with monopolizing an alleged market for Beckman brand reagents, chemicals used in Beckman brand blood analyzers to detect particular substances in the blood. The court granted summary judgment for the defendant because it was indisputable that Beckman

blood analyzers faced competition from other manufacturers. Hence, "if the overall cost of operating an analyzer, whether due to reagent cost, service costs or otherwise, is too high, then a hospital or lab will switch to purchase of another company's equipment." 670 F. Supp at 1321. This prevented any possible anticompetitive effect in any reagent market. *See also, Spectrofuge Corp. v. Beckman Instruments, Inc.*, 575 F.2d 256, 282 (5th Cir. 1978), *cert. denied*, 440 U.S. 939 (1979); *MLC, Inc. v. North American Philips Corp.*, 1983-1 Trade Cases (CCH) ¶ 65,351, p. 70,093 (S.D.N.Y. 1983).

Thus, there is unbroken precedent and sound reason supporting the District Court's grant of summary judgment. There is no reason to depart from those precedents.

B. Kodak's Policies Are Proper As a Matter of Law Because They Promote Interbrand Competition.

The District Court's ruling, and Kodak's policies, are supported by basic antitrust policy. As the Second Circuit stated in *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 276 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980), "[s]o long as we allow a firm to compete in several fields, we must expect it to seek the competitive advantages of its broad-based activity. . . . These are gains that accrue to any integrated firm, regardless of its market share, and they cannot by themselves be considered uses of monopoly power."

Kodak participates, and must remain competitive, in numerous interbrand equipment markets, including the markets for copy products and micrographics equipment. Interbrand competition in those equipment markets is

fierce, a fact that plaintiffs do not address, let alone dispute. Kodak, however, does not have the luxury of ignoring that competition. The policies that plaintiffs challenge are designed to make Kodak more competitive in the markets that matter to it — the interbrand markets for equipment.

Kodak has the right to take steps necessary to remain efficient. The fact that Kodak has developed a sufficiently popular product line to spawn a coterie of free riders does not obligate Kodak to support them for all time. *California Computer Products, Inc. v. International Business Machines Corp.*, 613 F.2d 727, 744 (9th Cir. 1979) ("IBM, assuminq it was a monopolist, had the right to redesign its products to make them more attractive to buyers . . . It was under no duty to help CalComp or other peripheral equipment manufacturers survive or expand.") Kodak's past success in the interbrand markets does not create special duties to support those, such as plaintiffs, who hinder its ability to remain competitive. "[A] defendant, having succeeded in legitimately controlling 'the best, most efficient and cheapest source of supply . . . ,' does not have to share 'the fruits of its superior acumen and industry.'" *General Business Systems v. North American Philips Corp.*, 699 F.2d 965, 979 (9th Cir. 1983).

Kodak's policies are reasonable efforts to retain its competitive position in the interbrand equipment markets. As the Supreme Court recognized in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 55 (1977) ("*Sylvania*"), "[s]ervice and repair are vital for many products, . . . The availability and quality of such services affect a manufacturer's goodwill and the competitiveness

of his product." 433 U.S. at 55. Kodak has made a substantial investment in product development and training, and service revenue is a part of the anticipated return on that investment. Plaintiffs are free to compete with Kodak, but Kodak does not have to support their efforts to take away the fruits of its investment. The District Court's ruling recognized that principle and is fully supported by the law of this Circuit.

II. KODAK CANNOT BE FORCED TO SELL PARTS TO ISOs UNDER APPELLANTS' TYING AND ASPEN ARGUMENTS

A. Kodak's Parts Policy is Not an Unlawful Tying Arrangement.

Plaintiffs' principal argument on appeal is that Kodak's unilateral decision not to sell parts to ISOs constitutes an unlawful tying arrangement. On its face that makes no sense. A tying arrangement exists when the sale of one product (the "tying product") is conditioned on the buyer's willingness to simultaneously purchase another product (the "tied product"). *Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2, 12 (1984) ("*Hyde*") If one refuses to sell a product under any conditions, as Kodak refuses to sell parts to ISOs, that is a unilateral refusal to deal, not a tying arrangement. As discussed above, unilateral refusals to deal do not violate the antitrust laws when undertaken by firms which, like Kodak, have no market power.

In both *Dimidowich* and *Nobel*, the courts concluded that refusals to sell replacement parts do not constitute tying arrangements. *Dimidowich*, 590 F. Supp. at 49, *aff'd*,

803 F.2d at 1478; *Nobel*, 670 F. Supp at 1328, *aff'd*, 831 F.2d at 538; *see also*, *General Business Systems v. North American Philips Corp.*, 699 F.2d 965, 977-78 (9th Cir. 1983) (summary judgment for defendant re equipment-service tie affirmed). That is also evident from a straightforward application of the elements of an unlawful tie-in to the facts of this case.

1. Kodak Does Not Tie Two Products Together.

The first element of any tying arrangement is that the sale of one product is conditioned on the buyer's willingness to purchase a second, distinct product. *Mozart Co. v. Mercedes-Benz of North America, Inc.*, 833 F.2d 1342, 1345 (9th Cir. 1987), *cert. denied*, 57 U.S.L.W. 3235 (Oct. 3, 1988). This not only defines the offense, it is central to defining the anticompetitive consequences of some tying arrangements, *i.e.*, the fact that customers are forced to buy a product which they otherwise would not buy. *See Hyde*, 466 U.S. at 12.

Throughout this litigation, Plaintiffs have paired up nearly every possible combination of Kodak equipment, parts, and service in search of a tying arrangement. On appeal, they pursue only one theory. They allege that Kodak has used its control over replacements parts (the "tying product") to force its customers to buy Kodak service (the "tied product").

That is simply and indisputably not true. Kodak does not require its copier or micrographics equipment customers to purchase Kodak service, and it does not prevent them from servicing their own equipment or

utilizing ISOs. Any Kodak equipment customer that wants to service its own equipment may buy all the parts it needs for that purpose from Kodak without any obligation to buy anything else. Of course, the customer must already own Kodak equipment, but they need not buy Kodak service, the alleged "tied product." Kodak's policy would constitute tying only if it required its parts customers to buy Kodak service to get parts. Indisputably, Kodak has no such requirement.

Plaintiffs' "tying" case is in reality based on the contention that Kodak will not sell parts to its equipment customers if it knows they will use an ISO, or if they are an ISO and want to use the parts to provide third party service.[4] (A.O.B., p. 21) That is still not tying. Tying arrangements force customers to buy something they do not want, not merely to refrain from buying or doing something they do want. Plaintiffs' argument simply points out that Kodak's unilateral refusal to sell parts to ISOs operates both directly, by not making sales to the ISOs themselves, and indirectly by not allowing ISOs to

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[4] Plaintiffs also try to carve out a narrow exception with respect to Kodak equipment sold by someone other than Kodak, what they call "brokered" equipment. (A.O.B. p. 21) Plaintiffs neglect to inform the Court that Kodak does not broker equipment. It only sells equipment directly to its customer. (Record, No. 14, Murray Decl. ¶¶ 24, 33; No. 15, Lacy Decl. ¶ 3) As to used equipment that may be sold by somebody else, Kodak requires that the equipment is in working order before it will offer service. (Murray Decl. ¶ 34; Gross Decl. ¶ 5) In any event, plaintiffs have abandoned on appeal their allegations that Kodak's used equipment policy is unlawful.

make arrangements with Kodak customers to circumvent the policy. Kodak has always admitted that it engages in that unilateral refusal to deal, and it is precisely what *Bushie, Calculators Hawaii,* and *Dimidowich* say Kodak may lawfully do. It is not tying.

2. Parts and Service Are Not Separate Products.

Another element of a tying arrangement is that the two products tied together must be economically distinct. *Hyde,* 466 U.S. at 19. There must be "sufficient demand" for one product so that "it is efficient to offer" that product separately from another. *Id.* at 21-22. Components of a single product can be packaged together without being deemed a tying arrangement. *Casey v. Diet Center, Inc.,* 590 F. Supp. 1561 (N.D. Cal. 1984).

Parts and service are not separate products for purposes of a tying analysis. Customers have no interest in having one without the other. Parts are sold only to facilitate service and service is dependent upon parts. There is no separate demand for each, *see, Hyde,* 466 U.S. at 19; to the contrary, the demand for parts is entirely derivative of the demand for service. For example, in *Allen-Myland, Inc. v. IBM Corp.,* 1988-2 Trade Cases, ¶ 68, 193 (July 22, 1988) the court found that the parts to a computer upgrade program and the service to install those parts were not separate products. *Id.* at 59,279. Customers may have wanted various suppliers of both, but had little interest in having parts and service supplied separately. *Id.*

Indeed, appellant's theory of their case effectively concedes that there is no separate demand and no efficient market for parts. Plaintiffs claim that they cannot obtain parts anywhere other than Kodak. (Record, No. 1, ¶ 23; A.O.B., p. 2) If parts could be sold efficiently in a separate market, they would be available to plaintiffs from some source other than Kodak. Plaintiffs cannot simply freeride on Kodak for its parts on the basis of an alleged tie between two distinct products.

Like a belt and its buckle, *Jack Walters & Sons Corp. v. Morton Building, Inc.,* 737 F.2d 698, 704 (7th Cir. 1984), or an engine and its warranty, *Klo-Zik Co. v. General Motors Corp.,* 677 F. Supp. 499 (E.D. Tex. 1987), parts and service are two sides of the same coin. Parts are worthless without service to install them, and service has no value without parts. They are not separate products.

3. Kodak Lacks Market Power

The next element of an unlawful tying arrangement is the possession by the defendant of "some special ability — usually called 'market power' — to force a purchaser to do something that he would not do in a competitive market." *Hyde,* 466 U.S. at 13-14; *Mozart,* 833 F.2d at 1345. Tying arrangements cannot harm competition if the seller lacks market power. "The primary purpose of the rule against certain tying arrangements is to stop the extension of market power from one product to another. [That] is impossible unless the seller has substantial market power in the tying product." *Mozart,* 833 F.2d at 1345 [citations omitted].

Plaintiffs concede that Kodak lacks market power in either of the relevant interbrand equipment markets, *i.e.*, the copier and micrographics equipment markets. They also concede that new purchasers could choose among many equipment vendors (and their associated service offerings) if the total costs of using Kodak equipment — including parts and service costs — were to rise substantially. (A.O.B., pp. 44-45) That means that Kodak lacks market power in not only the equipment markets, but also in the aftermarkets (even assuming they are separate markets) for parts and service.[5] The fact that Kodak customers can switch to competing equipment if Kodak tried to raise the price of parts or service is irreconcilable with plaintiffs' contention that Kodak has market power over parts. *See*, F.M. Fisher, et al., *Folded, Spindled, and Mutilated: Economic Analysis and U.S. v. IBM* (MIT Press 1983) at 202 (excerpts found in Authorities Appendix to Kodak's Reply Brief in Support of Motion for Summary Judgment).

[5] New customers and those who wish to replace or upgrade their equipment take into account the parts and service costs when choosing equipment. (Record, No. 14, Lacy Decl. ¶ 18, No. 15, Murray Decl. ¶ 16). The same is true of customers who stagger their purchases over time since there are no technological "lock-ins." (Record, No. 43, Spies Decl. ¶¶ 4-8). As to customers who have already purchased equipment, will not upgrade, and have no plans for any future purchase, they will pay the same price for parts and service as everyone else. That is because competition for new customers (or those otherwise free of any theoretical lock-in) sets the market price. See F.M. Fisher, at 202. The ultimate proof that Kodak customers are not locked-in is the fact that Kodak regularly loses existing customers to its equipment competitors. (Record, No. 15, Lacy Decl. ¶ 17; No. 14, Murray Decl. ¶ 16)

The Ninth Circuit recognized this on closely analogous facts in *General Business Systems v. North American Philips Corp.*, 699 F.2d at 977-78. There the defendant Philips was a computer maker that was charged with using its market power in an alleged service market to force its customers to buy its own magnetic ledger cards ("mlcs"). Thus mlcs (the "tied products") were said to be tied to service (the "tying product"). The court affirmed a summary judgment for Philips on the ground that interbrand equipment competition precluded any finding of market power over service. *Id.* at 977. The relevant equipment market — small business computers — was highly competitive. and the Court found that any attempt by Philips to exercise market power with respect to service "only would have hastened the date on which Philips surrendered to its competitors in the small business computer market." *Id.*

Plaintiffs' market power case ignores the forces of interbrand equipment competition. They argue instead that Kodak has market power over parts simply because Kodak parts are "unique." (A.O.B. at 31.) That is true in a literal sense, but no more true than the general proposition that *all* branded products are "unique." *See United States v. E.I. du Pont & Co.*, 351 U.S. 377, 393 (1956) ("one can theorize that we have monopolistic competition in every nonstandardized commodity"). The important point is that so long as consumers can switch to Kodak's many competitors should Kodak try to exert market power by forcing its parts customers to buy other products, there is *a fortiori* no market power over parts. That is true whether or not the parts are "unique."[6]

[6] The allegation that some parts may be patented does not add anything to plaintiffs' "uniqueness" argument and by

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Plaintiffs' market power case also relies heavily on this Court' controversial decision in *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336 (9th Cir. 1984).[7] Plaintiffs allege that existing Kodak equipment customers (but not new prospects) are "locked-in" to Kodak products such that they cannot switch to competing vendors if Kodak tries to exert market power over parts. They claim that in *Digidyne* this Court established that a lock-in is sufficient to prove tying market power.

Plaintiffs are wrong on both the law and the facts. First, there is nothing in *Digidyne* to suggest that a manufacturer which, like Kodak, indisputably faces strong interbrand equipment competition can be found to have market power on the basis of a lock-in. In fact, *Digidyne* strongly implies the contrary. Data General argued that lock-in was irrelevant in determining its market power because buyers were aware of the potential lock-in when initially selecting Data General's product and could

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itself makes no difference. *See Hyde*, 466 U.S. at 37, n. 7; *Allen-Myland* at 59,272-73; *Klo-Zik*, 677 F. Supp. at 499.

[7] *Digidyne's* analysis has been expressly rejected by several courts. *See A.I. Root Co. v. Computer/Dynamics, Inc.*, 806 F.2d 673, 676 (6th Cir. 1986); *Will v. Comprehensive Accounting Corp.*, 776 F.2d 665, 673 n. 4 (7th Cir. 1985), *cert. denied*, 475 U.S. 1129 (1986); *Allen-Myland* at 59,273, n. 42; *Tominaga v. Shepherd*, 682 F. Supp. 1489, 1495 (C.D. Cal. 1988). In addition, Justices White and Blackmun — two of the five Justices who favor retention of the per se rule in tying cases — would have granted certiorari in *Digidyne*. *See* 473 U.S. 908 (White, J., joined by Blackmun, J., dissenting from denial of certiorari). The Ninth Circuit itself criticized and narrowly interpreted *Digidyne* in *Mozart*, 833 F.2d at 1346 n. 4. It is not a case to be read expansively.

choose not to lock themselves in. *Id.* at 1342. The Ninth Circuit did not quarrel with the logic of this argument; indeed it seemed to accept it. Rather, the Court found that factors other than the lock-in gave Data General that initial leverage. *Id.* at 1343 (citing the copyright protection of Data General's product, its "special attraction," trade secret barriers, and other barriers to the development of comparable products). Here, it is undisputed that consumers may freely choose between a wide variety of vendors when initially choosing copiers or micrographics equipment. (Record, No. 14, Murray Decl. ¶ 5; No. 14, Lacy Decl. ¶ 8; A.O.B., pp. 44-45) It is also undisputed that copier and micrographics equipment customers consider long term parts and service costs when choosing between Kodak and its equipment competitors. (Record. No. 14, Murray Decl., ¶¶ 15, 22; No. 15, Lacy Decl., ¶ 14; *see also* p. 30, n.5, *supra*) Nothing in *Digidyne* suggests that a lock-in can prove market power under those circumstances.

Second, Plaintiffs have failed to raise a triable issue regarding the existence of any meaningful lock-in. At the District Court, Plaintiffs' lock-in case was based primarily on a totally unfounded allegation that compatibility requirements between components of a micrographics system prevented customer switching. They have now wisely abandoned that allegation. All they are left with is a senseless claim that that because Kodak equipment loses value after it is purchased, customers would prefer to hold on to the equipment for its full useful life.

The District Court correctly rejected this argument. Almost every product has a lower "used" price than its "new" price; it is practically American folklore that an

automobile loses value the minute it leaves the showroom. But that does not and cannot mean that every manufacturer of a product that loses value has market power or that its customers are locked-in to it. Consumers can be expected not to buy durable goods unless they are satisfied that they are not committing to a poor or costly product. This is the point that the Ninth Circuit noted, and seemed to concede, in *Digidyne*, 734 F.2d at 1342. There is, moreover, undisputed evidence that copier and micrographics customers consider long term costs before committing to Kodak or any other vendor. (Record, No. 14, Murray Decl. ¶ 22; No. 15, Lacy Decl. ¶ 14) There is no probative evidence to the contrary.[8]

Therefore, the undisputed evidence proves that Kodak (a) did not tie service to parts, and (b) could not

[8] The evidence plaintiffs rely on is both senseless and inadmissible. They claim, for example, that a copier selling for $75,000 new has a $2,500 resale value after two to three years, or just twenty percent of what plaintiffs claim is its 14 year useful life. (A.O.B., p. 10) If that were true — if one could really purchase eighty percent of the value of a copier for less than four percent of its original price — no customer would ever buy a new copier, at least not unless Kodak lowered its new equipment prices drastically. Yet contradictorily, plaintiffs insist that the market for these alleged bargains has "dried up." (Record No. 40, Vaning Decl. ¶ 20) Of course, none of this could really happen. Moreover, plaintiffs cite no admissible evidence to support their claim. Plaintiffs speak in conclusory terms of the "drop" in prices for unspecified equipment of unspecified condition. (*Id.* ¶ 16) Their declarations fail to mention the specific price of even a single used copier, let alone the age of the copier, or its price when it was new. (*See* Record. No. 40, Hermandez Decl. ¶ 56) These "facts" simply do not support the proposition plaintiffs assert.

have adversely affect competition had it done so since it has no market power in the tying market.

4. Kodak's Parts Policy is Justified by Valid, Pro-competitive Business Reasons.

In *Mozart Co. v. Mercedes-Benz of North America, Inc.*, 833 F.2d 1342, 1349 (9th Cir. 1987), *cert. denied*, 57 U.S.L.W. 3235 (Oct. 3, 1988), this Court held that even an otherwise unlawful tying arrangement "does not violate the antitrust laws 'if implemented for a legitimate business reason and if no less restrictive alternative is available.' " *See also, Phonetele, Inc. v. American Tel. & Tel. Co.*, 664 F.2d 716, 739 (9th Cir. 1981, *cert. denied*, 459 U.S. 1145 (1983). *Mozart* concluded that Mercedes-Benz' requirement that its franchisees use only Mercedes-Benz manufactured replacement parts in their service operations was justified by quality control considerations. *Mozart*, 833 F.2d at 1348-51. Mercedes-Benz could compel its dealers to use only its parts in order to prevent substitution of inferior parts by dealers "freeriding" on the overall quality of Mercedes-Benz service. *Id.* at 1349.

Even if Kodak's policy were a tying arrangement, which it is not, it would be justified by Kodak's legitimate business interests. Kodak has adopted the parts policy because (a) it believes that by taking direct responsibility for the repair and maintenance of its products it can better compete against other equipment manufacturers, (b) it can reduce inventory costs, and (c) it does not want to support free-riders who do nothing but take away revenues that are rightfully part of Kodak's return on its investment in manufacturing. Every one of those reasons,

and the parts policy itself, promotes interbrand competition between equipment manufacturers. And that, interbrand competition, "is the primary concern of antitrust law." *Sylvania*, 433 U.S. at 52 n.19.

The courts have frequently recognized that promoting good service in order to make a product more attractive fosters interbrand competition. Thus, they have upheld against antitrust challenge a wide variety of vertical restrictions designed to improve a manufacturer's competitiveness by assuring adequate service for the manufacturer's products. *See, e.g., Davis-Watkins Co. v. Service Merchandise*, 686 F.2d 1190, 1195-1201 (6th Cir. 1982); *Copy-Data Systems, Inc. v. Toshiba America, Inc.*, 663 F.2d 405, 410 (2d Cir. 1981). In *Sylvania* itself, the Supreme Court recognized that "service and repair are vital for many products," and that restrictions designed to ensure adequate service of a manufacturer's products could make those products more attractive, and thereby enhance interbrand competition. 433 U.S. at 55.

Kodak's desire to reduce inventories by not making, buying or stocking parts for ISOs is also pro-competitive. Eliminating costs unnecessary to delivering its own product — Kodak equipment and associated service — makes Kodak more efficient. Promoting efficiency is one of the principal goals of the antitrust laws. *See Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 21-22 (1979); *N.C.A.A. v. Board of Regents of the University of Oklahoma*, 468 U.S. 85, 103 (1984). Interbrand competition is directly served by policies which increase Kodak's efficiency.

Finally, the courts have frequently recognized that interbrand competition is promoted by policies which eliminate free riders. *Sylvania*, 433 U.S. at 55; *Mozart*, 833 F.2d at 1349; *JBL Enterprises, Inc. v. Jhirmack Enterprises, Inc.*, 698 F.2d 1011, 1015 (9th Cir. 1982), *cert. denied*, 464 U.S. 829 (1983) (firms "more likely to expend the effort necessary to promote or service a product if they did not have to worry about [others] taking a 'free ride' on their efforts"); *O.S.C. Corp. v. Apple Computer, Inc.*, 792 F.2d 1464, 1468 (9th Cir. 1986) (elimination of "free riders" to promote interbrand competitiveness "is both legitimate and lawful."). Therefore, Kodak's refusal to support the efforts of ISOs to free ride on Kodak's investment in the copier and imaging equipment businesses is also pro-competitive.

Therefore, even if one were to assume that Kodak's policy was a tying arrangement, it would not be unlawful under *Mozart*.

B. *Aspen* Does Not Obligate Kodak to Sell Parts to Appellants.

Plaintiffs' second major argument on appeal is that, under the Supreme Court's *Aspen* decision, Kodak could not lawfully change its policy and refuse to sell ISOs parts after initially having made such sales. This argument, which was not raised below, is specious.

To begin with, *Aspen* is a Sherman Act § 2 case in which the defendant conceded that it possessed monopoly power in the relevant market. 472 U.S. at 596. It concerns the obligations that monopolists have to deal

with their competitors. It says nothing about the obligations of a firm like Kodak, which indisputably lacks market power in the copier and micrographics equipment markets. *Bushie, Calculators Hawaii,* and *Dimidowich* establish that manufacturers lacking interbrand market power need not sell parts to competitors.

Second, contrary to plaintiffs' argument, *Aspen* does not stand for a broad proposition that monopolists who choose to deal with their competitors can never change their minds. The issue in *Aspen* was much more narrow. The plaintiff and the defendant had voluntarily agreed to participate in a joint marketing arrangement in which their separate products (skiing at their respective mountains) were sold together in an all-Aspen lift ticket. *Id.* at 589-93. The cooperative venture had originated at a time when the market was competitive, it persisted for sixteen years, and the Supreme Court clearly felt that in light of its longevity and consumer acceptance it was the "optimal" pattern of distribution in the relevant market. *Id.* at 604-07 & n. 31. The defendant terminated its participation in the venture after it acquired monopoly power, and notwithstanding its willingness to continue participating in similar ventures in other markets where it was not a monopolist. *Id.* at 608-09. Moreover, the defendant had "fail[ed] to offer any efficiency justification whatever" for its unwillingness to continue the venture. *Id.* at 608.

Cases decided subsequent to *Aspen* have interpreted it narrowly. *Olympia Equipment Leasing Co. v. Western Union Telegraph Co.*, 797 F.2d 370 (7th Cir. 1986), held that a monopolist could lawfully extend help to new entrants and later withdraw that support. "A monopolist has no duty . . . to extend a helping hand to new entrants." 797

F.2d at 376, *citing California Computer Products, Inc. v. International Business Machines Corp.*, 613 F.2d 727, 744 (9th Cir. 1979).[9] Similarly, in *Oahu Gas Service, Inc. v. Pacific Resources Inc.*, 838 F.2d 360 (9th Cir.), *cert. denied*, 57 U.S.L.W. 3235 (Oct. 3, 1988), this Court recently declined to read *Aspen* expansively. The Court held that even monopolists have a duty to assist competitors *only* when there is no business justification for the refusal. *Id.* at 368. That is clearly not the case here. (*See* pp. 9-13, *supra*)

In any event, the facts in *Aspen* are not even remotely comparable to the case at bar. The plaintiff and defendant in *Aspen* banded together to offer a joint product to the public, because that cooperative effort increased the profitability of both. Such a mutually beneficial cooperative relationship has never existed between plaintiffs and Kodak. To the contrary, plaintiffs simply allege that, in the past, they purchased some parts from Kodak, in order to offer those parts to others, in an effort to take revenues

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[9] Plaintiffs' argument that this case is an "essential facility" case under *Olympia Leasing*, and that Kodak is therefore obligated to provide parts to them (A.O.B., p. 46) is ill-conceived and unavailing. Plaintiffs are not pre-existing parts "customers" who have chosen to compete with Kodak for service contracts. Other than to take revenues away from Kodak, they have no desire for the Kodak parts they wish to buy. In any event, this case cannot be an essential facility case. As in *Olympia Leasing*, the purportedly monopolized facility is potentially available to plaintiffs. They simply prefer not to look to other sources or to make the investment necessary to develop the parts themselves. Just as *Olympia* "had no right to take a free ride on its competitor's sales force." 797 F.2d at 377-78, plaintiffs have no right to free ride on Kodak's parts investment.

away from Kodak.[10] They were, in short, free riders. That is not the type of special, efficient relationship that existed in *Aspen*.

Neither is there any evidence here that Kodak made a significant change in its policy: Kodak has always declined to sell copier parts to ISOs, and when it adopted that policy for newly introduced micrographics products, it continued selling parts for its existing micrographics products to ISOs, as it does today. Finally, there is no claim made here that Kodak's decisions to adopt the challenged parts policies were in any way related to its acquisition of monopoly power. To the contrary, it is conceded that Kodak is not a monopolist in the relevant equipment markets. (A.O.B., p. 44) And there is no evidence here that Kodak is willing to cooperate with some ISOs but not others.

Even more fundamentally, Kodak has demonstrated sound, pro-competitive business reasons for its decision not to sell parts to ISOs. *Aspen* explicitly holds that a refusal to deal, even by a monopolist, is lawful if based on valid business reasons. 472 U.S. at 605. This Court, interpreting *Aspen*, recently held that a legitimate business justification will excuse a monopolist's refusal to deal even when the refusal "is based partially on a desire to restrict competition." *Oahu Gas*, 838 F.2d at 368.

[10] To the extent that Kodak ever sold parts to plaintiffs, it either did so unwittingly (as was the case with respect to sales of copier parts or newer micrographics parts which may have occurred) or in the context of a normal commercial sale (as Kodak has sold *and continues* to sell older micrographics parts to ISOs). (*See* pp. 8, 13-14, *supra*)

Aspen is of no help to plaintiffs. To the contrary, the Supreme Court's carefully limited holding reaffirms that even monopolists may ordinarily refuse to deal with their rivals without violating the Sherman Act.

C. It Is Undisputed that Kodak Acted Unilaterally.

Plaintiffs' complaint alleged a myriad of conspiracies between Kodak and virtually every other type of firm in the copier and micrographics industries (with the exception, ironically, of any Kodak competitor). (Record, No. 1, Complaint ¶¶ 52-56.) These allegations have now evaporated completely. Other than a passing reference in their Statement of Facts (A.O.B., p. 14), plaintiffs do not pursue any conspiracy claim on appeal. No such claim is included in either plaintiffs' Statement of Issues Presented for Review or their Argument. It is thus conceded that Kodak acted unilaterally in adopting and implementing the challenged policies. *A fortiori*, the District Court was correct in granting summary judgment on plaintiffs' Section 1 claims. *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 761 (1984) ("Independent action is not proscribed" by Section 1); *Spectrofuge Corp. v. Beckman Industries, Inc.*, 575 F.2d 256, 286 (5th Cir. 1978), *cert. denied*, 440 U.S. 939 (1979) ("It is axiomatic that unilateral activity by a single firm cannot be reached with this section").

CONCLUSION

This case stands for the simple proposition that a manufacturer which lacks market power cannot be forced to sell replacement parts to freeriders who would rather

not make their own parts. *Bushie* established the principle sixteen years ago; *Calculators Hawaii* and *Dimidowich* reaffirmed it; and it has spread to every other circuit to consider the issue.

There is no question that Kodak has a significant advantage over plaintiffs in competing for service business: Kodak has plenty of parts. But Kodak has those parts because it has invested in the development and manufacture of copiers and micrographic equipment, investments which undoubtedly benefitted both competition and consumers — indeed, which also benefitted plaintiffs. As a "reward" for its efforts. Kodak should not now be required "to immolate itself" by selling ISOs parts that can only be used to take away revenues that would otherwise reward Kodak's investment. *Homefinders of America, Inc. v. Providence Journal Co.*, 621 F.2d 441, 443 (1st Cir, 1980). Such a rule makes no sense. It would deter investment in manufacturing and thus would be distinctly anticompetitive.

Accordingly, the District Court's order granting Kodak's motion for summary judgment should be affirmed.

Dated: November 10, 1988

Respectfully submitted,

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STATEMENT OF RELATED CASES

Eastman Kodak Company is aware of no case pending before this Court that is related to this case.

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

NO. 88-2686

IMAGE TECHNICAL SERVICES, INC., et al.
Plaintiffs-Appellants,

v.

EASTMAN KODAK COMPANY,
Defendant-Appellee.

APPEAL FROM THE SUMMARY JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA

REPLY BRIEF OF APPELLANTS

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I. INTRODUCTION.

Although it is presented in many different forms, the argument in appellee Kodak's response brief can be reduced to one simple proposition: the antitrust laws do not "impose a duty" on a firm such as Kodak to assist its competition. Of course, the Sherman Act imposes no such duty, and appellants do not contend otherwise. The antitrust laws *do*, however, impose a duty on a firm such as Kodak to compete fairly, and over the years that duty has been interpreted to prohibit tie-ins and sudden cut-offs of arrangements by a monopolist to destroy competitors. It is just such conduct that Kodak has engaged in here, and although many pages of Kodak's response brief ("K.R.B.") are devoted to justifying such conduct, Kodak does not seriously dispute that it has occurred.

Plaintiffs announced on page 1 of their brief that this is a tying case brought under Section 1 of the Sherman Act and controlled by *Digidyne*, as well as a monopolist's competitor-exclusion case brought under Section 2 of the Sherman Act controlled by Supreme Court and Ninth Circuit precedents. Kodak tries simply to ignore these facts; it first addresses the Section 1 tying issue on page 25 of its 44-page brief, first mentions *Digidyne* on page 32, and devotes only four pages near the end of its brief to the Section 2 claims (K.R.B. at 38-42). Kodak never mentions the *Otter Tail Power Co. v. U.S.* or the *Pacific Coast Agricultural Export Assn. v. Sunkist Growers* precedents of

the Supreme Court and of the Ninth Circuit, relied upon by plaintiffs, the rules of which, with *Lorain Journal* and *Aspen*, dictate finding a Section 2 violation.

Kodak uses the first half of its brief not to respond to plaintiffs' argument that the district court erred, but rather to regurgitate the same irrelevant argument it made to the district court that this is a refusal-to-deal case controlled by the rationale set forth in some distributor termination cases. Although the district court was misled into error by Kodak's argument, this Court should not be. Try as it might, Kodak cannot convert this tying/competitor-exclusion case into a simple distributor-termination "refusal-to-deal" case.

In their opening brief, plaintiffs anticipated that Kodak would resurrect its "refusal-to-deal" argument and went on to demonstrate that:

> [A]lthough Kodak, as sole distributor of its own parts, might not run afoul of Sherman Act Section 1 merely by "choosing" its own customers, Kodak *does* violate that law if, in "choosing" its parts customers, it forces those customers also to buy its service by means of an "impermissible method," such as tying arrangements. Any ability of Kodak legally to refuse to deal with ISOs does not insulate it from liability for illegally tying its service to its parts.

(A.O.B. at 36.)

Kodak's response brief nowhere comes to grips with this fundamental reality: *refusal-to-deal cases do not validate illegal tying arrangements*. Otherwise, *every* illegal tying case could be analyzed as, and thrown out of court as, a legal "refusal-to-deal" case. The ruling would be that

defendant does not "tie" product A to product B, it merely "refuses to deal" with those customers who wish to purchase only product B from defendant and who prefer to purchase product A elsewhere. Such reasoning would abolish illegal tying arrangements in this Circuit, yet that is precisely the reasoning Kodak suggests to this Court, and precisely the result Kodak requests this Court to reach. Kodak must not be allowed to escape liability for its illegal tying arrangements by contorting them into simple refusals to deal.

As shown in Section II below, Kodak's response brief admits that Kodak's arrangements with its customers constitute tying arrangements, implicitly admits that the district court "missed" the facts constituting the tie, and tries to justify the tie by means of "[v]alid, [p]ro-competitive [b]usiness [r]easons." (K.R.B. at 35.) Because the district court "missed" the tie, neither side's factual contentions regarding the legality of the tie were ever addressed by that court, and this two requires reversal. The erroneous summary judgment of the district court – granted without the benefit of oral argument and based on a conceded misunderstanding of the facts – must be reversed and a determination made whether plaintiffs' evidence in this record makes Kodak's tie-ins *per se* illegal or whether the case should be remanded to the district court for determination, by the finder of fact of whether Kodak's "business reasons" validate its tie.

As shown in Section III below, reversal is also required because the principles set down in *Otter Tail, Lorain Journal, Aspen* and *Pacific Coast Agricultural Export Association* preclude Kodak, under the circumstances present here, from exerting its conceded monopoly power

over the sale of Kodak *parts* at wholesale to put competitors out of business at a different level of distribution – the sale of *service* to Kodak equipment owners at retail. Kodak's basic argument that "interbrand competition" for *new machines* justifies its monopolization of service and elimination of service competitors because the interbrand market is the only relevant market to measure market power and competitive effect, does not comport with reality. As Chief Justice Hughes stated in *Appalachian Coals, Inc. v. U.S.* 288 U.S. 344, 360, 377 (1933) (as quoted in *Sylvania*, 433 U.S. at 47):

> "Realities must dominate the judgment . . . . The Anti-Trust Act aims at substance".

The simple reality and substance is as described by this Court in *Dimidowich*:

> [A]n owner of broken B & H micrographic equipment is indifferent to people who can service Kodak or 3M machines. If the owner's only option is to request service from B&H or Comgraphix (depending on his location) [both B&H repairers], that is obviously the market the owner faces. 803 F.2d at 1481 n.3.

The realities are: (1) an owner of Kodak equipment looks to service offered for Kodak machines, not "interbrand competition" in equipment; (2) ISOs cannot service Kodak equipment without Kodak replacement parts, the market for which Kodak monopolizes; and, (3) the elimination of ISO service, if Kodak prevails, will have a tremendous anticompetitive impact on competition for *service* of Kodak machines. There are three relevant markets here: (1) the new equipment market; (2) the parts market; and (3) the service markets.

II. KODAK HAS ADMITTED ITS TYING ARRANGEMENTS, AND THE ELEMENTS OF PER SE VIOLATIONS HAVE BEEN ESTABLISHED.

Kodak in its brief concedes precisely the three arrangements identified in plaintiffs' opening brief whereby Kodak ties service (the tied product) to its parts (the tying product). It characterizes these arrangements as follows:

> Plaintiffs' "tying" case is in reality based on the contention that Kodak will not sell parts to its equipment customers if it knows they will use an ISO [for service], or if they are an ISO and want to use the parts to provide third party service . . . Plaintiffs also try to carve out a narrow exception with respect to Kodak equipment sold by someone other than Kodak, what they call "brokered" equipment.

(K.R.B. at 27 and 27 n.4.)

Kodak thereafter fails to offer any factual evidence which refutes that these arrangements exist. Kodak cannot, since its own evidence confirms the ties. Kodak, however, attempts to escape these ties in three ways: (1) it claims the ties are just a "contention"; (2) it invents its own definition of a tie and says these ties do not fit; (3) it says these are not ties at all but rather legal refusals to deal. All three arguments fail.

A. The Tie-Ins Exist As A Matter Of Law.

Kodak refers to these three ties as a "contention" because the district court simply missed them. Indeed, the court below erroneously found "[t]here is no evidence of any such [*Northern Pacific* tying] arrangement in this

case." (Excerpts, p. 5, ll. 4-5.) To the contrary, there is *overwhelming* evidence of these three ties that was extensively quoted in plaintiffs' opening brief, all of which evidence is included in the Excerpts of Record. (A.O.B. at 20-26.) That evidence includes Kodak's own verified interrogatory answers, Kodak's own declarations in support of its summary judgment motion, the sworn deposition testimony Kodak's own witnesses (under questioning by Kodak's own attorneys), and Kodak's own documents contemporaneously prepared by Kodak personnel in charge of implementing Kodak's restrictive parts sales policy. Kodak did not provide to the court below any evidence to rebut these tie-ins. This Court should therefore find as a matter of law that the facts support these tie-ins.

B. The Tie-Ins Fall Within the *Northern Pacific* Rule.

Recognizing that there is unchallenged evidence for plaintiffs' tying "contention," Kodak next asserts "[t]hat is still not tying" (K.R.B. at 27) and then, without citation to authority, invents its own definition of tying: "Tying arrangements force customers to buy something they do not want, not merely to refrain from buying or doing something they do want." (*Id.*) That is a clear misstatement of the law. Plaintiffs submit that this Court should rely on the Supreme Court's definition of tying in *Northern Pacific*, rather than on Kodak's new invention. The Supreme Court's definition is considerably more expansive than Kodak's, and makes it clear that the existence of a violation does not turn on whether the purchaser "wants" the second, tied product:

> [A] tying arrangement may be defined as an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier.

(*Northern Pacific Ry. v. U.S.*, 356 U.S. 1, 5-6 (1958) (footnote omitted).)

The second clause of the *Northern Pacific* definition shows that a tying arrangement exists if the sale of the tying product (parts) is conditioned on the buyer's agreement that it will not purchase the tied product (service) "from any other supplier," *i.e.*, on the condition that buyers (in contradiction of Kodak's definition) "refrain from buying or doing something they do want," namely, buying the tied product (service) at a better price from a different supplier (an ISO). As shown in plaintiffs' opening brief, Kodak conditions the sale of its parts in three ways, each of which constitutes a tie under *Northern Pacific*: Kodak sells parts to equipment owners (1) on the *condition* that they agree not to purchase service from an ISO; (2) on the *condition* that they also purchase Kodak service if they own equipment that was purchased as used equipment (referred to as "brokered equipment" in plaintiffs' opening brief); and/or (3) on the *condition* that they also purchase Kodak service if they are an ISO (lest the ISO use the parts to service its customers' machines).

C. The Tie-Ins Are Not Simple Refusals To Deal.

These three admitted *conditions* on Kodak's sales of parts to Kodak Equipment owners demolish Kodak's third argument to escape tying liability, which is Kodak's

almost ludicrous assertion that it does not sell parts under "any" conditions and hence is engaging in a simple refusal to deal:

> If one refuses to sell a product under *any* conditions, as Kodak refuses to sell parts to ISOs, that is a unilateral refusal to deal, not a tying arrangement.

(K.R.B. at 25.)

Kodak's sales of its parts to Kodak equipment owners, subject to the three conditions enumerated above, constitute a *Northern Pacific* tying arrangement, pure and simple.

D. Kodak's "Refusal to Deal" Defense Does Not Insulate It From the Illegal Tie-Ins.

It is true, of course, that *apart* from its tying arrangement with its equipment owners, Kodak, in order to monopolize service, *also* now refuses to sell parts directly to its competitor-ISOs, although it formerly did. That refusal to sell to competitors ("competitor exclusion") violates the principles of *Otter Tail, Lorain Journal, Aspen* and *Pacific Coast Agricultural Export Assn.*, as discussed in Section III below. But Kodak's sudden blanket refusal to sell parts *to ISOs* does not make Kodak's conditional sales *to equipment owners* any less of a tie. As stated in plaintiffs' opening brief, "[a]ny ability of Kodak legally to refuse to deal with ISOs does not insulate it from liability for illegally tying its service to its parts." (A.O.B. at 36.) Kodak in its "responsive" brief does not mention – much less refute – that statement, because it is irrefutable. Thus, Kodak's extensive reliance on distributor-termination

cases such as *Bushie v. Stenocord Corp.*, 460 F.2d 116 (9th Cir. 1972), which uphold certain limited refusals to deal as vertical non-price restraints by a manufacturer substituting one exclusive distributor for another, is inapposite to Kodak's conditional sales of parts to its equipment owners, which constitute tying arrangements.

That refusal-to-deal cases are inapposite to tying cases was explained by the first case cited on page 1 of Kodak's responsive brief, *Dimidowich v. Bell & Howell*, 590 F. Supp. 45 (C.D. Cal. 1984), *tying claim withdrawn on appeal*, 803 F.2d 1473 (9th Cir. 1986), *modified*, 810 F.2d 1517 (9th Cir. 1987). There, as established in plaintiffs' opening brief (and never refuted by Kodak in its responsive brief), the district court first found that Bell & Howell's parts policy did not constitute a tie because, unlike Kodak's policy, a Bell & Howell equipment owner *could* purchase a part from Bell & Howell and purchase the service to install that part separately from an ISO. (590 F.Supp. at 49; 803 F.2d at 1475; A.O.B. at 40-41.) After finding no tie, the court went on to determine whether the *Bushie* refusal-to-deal cases *independently* required Bell & Howell to sell parts directly to ISOs and concluded that, "absent impermissible methods and effects," they did not. (590 F.Supp. at 49-50 and 50 n.7; A.O.B. at 36.) A tying arrangement is clearly an "impermissible method." The *Dimidowich* court recognized this by first examining Bell & Howell's policy to determine if it constituted a tie. If it did, the *Bushie* refusal-to-deal line of cases would not have justified that tie (as Kodak incorrectly urges here). Otherwise, the *Dimidowich* court would simply have cited the *Bushie* refusal-to-deal principle, and never bothered to examine whether there was a tie.

That is what Kodak convinced the district court to do in this case, and is now trying to have this Court do: declare that the *Bushie* refusal-to-deal principle insulates Kodak from liability even for utilizing "impermissible methods" such as its tie-ins.

The only issue in this case is *not*, as Kodak suggests, whether "the antitrust laws impose a duty on a manufacturer . . . to sell replacement parts *to ISOs* . . . . " (K.R.B. at 2, emphasis supplied.) The issue with regard to Section 1 of the Sherman Act is whether the antitrust laws forbid Kodak from illegally tying its service to its parts when it sells parts *to its equipment owners*. The antitrust laws do forbid such conduct.

Kodak apparently recognizes this, for it offers ten pages of "assuming *arguendo*" arguments suggesting that "even if one were to assume that Kodak's policy was a tying arrangement, it would not be unlawful" under a variety of rationales. (K.R.B. at 28-38.) Of course, each of these arguments at best raises issues of fact, none of which were addressed by the court below because that court completely missed the tie. Plaintiffs in their opening brief demonstrated, by extensive citation to the record that they advanced in the district court, overwhelming evidence to show, at the very least, "genuine factual issues that can be resolved only by a finder of fact *because they may reasonably be resolved in favor of either party*," to quote *California Architectural Building Products, Inc. v. Franciscan Ceramics, Inc.*, 818 F.2d 1466, 1468 (9th Cir. 1987), *cert. denied*, 108 S.Ct. 698 (1988) (emphasis in original), relied on by Kodak. Accordingly, reversal and remand is required.

E. Parts and Service Constitute Separate Products.

In its first *"arguendo"* argument, Kodak asserts that "[p]arts and service are not separate products," but, "[l]ike a belt and its buckle," are "two sides of the same coin." (K.R.B. at 28-29.) But plaintiffs have already shown in their opening brief that, according to the Supreme Court in *Jefferson Parish*, the test is whether there are "two distinct markets for products that [are] distinguishable in the eyes of buyers." (*Jefferson Parish Hospital v. Hyde*, 466 U.S. 2, 19 (1984); A.O.B. at 28-29.) The existence of distinct markets distinguishable to buyers is a *factual* question that turns on the testimony of buyers and the actions of sellers. Plaintiffs believe they have demonstrated as a matter of law that parts and service are separate products, because Kodak admits it sells parts *separately* from service to "[a]ny Kodak equipment customer that wants to service its own equipment . . . " (K.R.B. at 26), and because customers in large numbers buy parts and service separately. Surely, in *those* buyers' eyes, parts are distinguishable from service. The very existence of the extensive customer base of the eighteen plaintiffs from throughout the United States in this action (customers whose parts are purchased from Kodak but whose service comes from ISOs), shows separate and distinguishable products. Kodak has offered no evidence to refute this.

This Circuit in *General Business Systems v. North American Phillips Corp.*, 699 F.2d 965 (9th Cir. 1983), relied upon by Kodak, recognized that accessory parts for small business computers could constitute a tied product, and that service on those computers could constitute a tying product (or service):

> [Plaintiff] rests its tying claim on an alleged attempt by [defendant] to expand sales of [defendants' specially manufactured accessory parts called] mlcs, the tied product, by denying service and warranty protection, the tying service, to computer owners who did not use these mlcs.

(699 F.2d at 977.)

Here, of course, it is Kodak's replacement parts which are the tying product, and Kodak's service which is the tied product, but the *General Business* analysis is directly applicable.

Indeed, in the principal "separate products" case relied upon by Kodak, *Allen-Myland, Inc. v. IBM Corp.*, 1988-2 Trade Cas. ¶ 68,193 (E.D. Pa. 1988), the district judge, following *Jefferson Parish*, cited and quoted extensive testimony of "end-users" of the product and service at issue to the effect that those users "had no interest in separately acquiring the parts for upgrades and shopping around for installation services." *Id.* at 59,279 and n.71. Only after this factual inquiry did he conclude that the peculiar service and parts at issue there were not separate "products" for tying purposes. Here, Kodak's own documents show that many of its equipment owners prefer ISO service (A.O.B. at 22-28 and 32) but cannot use ISOs because, if they do, Kodak will not sell them parts (K.R.B. at 27). These customers clearly recognize parts and service as separate products.

This record supports a finding that parts and service *are* separate products. Even if the factual determination of what buyers perceive to be separate products cannot be made in this tribunal on this record, the judgment must

still be reversed and the case remanded for a determination of this by the trier of fact.

F. Kodak's "Business Reasons" Do Not Insulate It From the Illegal Tie-Ins.

Similarly, Kodak's suggestion (K.R.B. at 35-38) that "valid, pro-competitive business reasons" (such as recovery of research costs and "interbrand competition") justify its otherwise unlawful tying arrangement, citing *Mozart Co. v. Mercedes-Benz of North America, Inc.*, 833 F.2d 1342 (9th Cir. 1987), *cert. denied* 109 S.Ct. 179 (1988), is not supported by the record. Plaintiffs submit that Kodak has an uphill battle on this issue, since *Mozart* holds that business reasons can justify ties *only* "if no less restrictive alternative is available," 833 F.2d at 1349, *quoting Phonetele, Inc. v. AT&T*, 664 F.2d 716, 739 (9th Cir. 1981), *cert. denied*, 459 U.S. 1145 (1983). The record shows that plaintiffs are willing to, and do, pay prices 100% higher than other customers of Kodak for parts, that Kodak can thus recoup its research, development and inventory costs through sensitive pricing of its replacement parts, and that such a pricing mechanism is much "less restrictive" than Kodak's tying arrangement. Plaintiffs demonstrated this in their opening brief, but Kodak, again, was unable to respond. As discussed in Section III. E. below, Kodak's other "business reasons" proffered for its policy changes are invalid as well.

G. Kodak Has Relevant Market Power.

Kodak next submits that it lacks market power in every conceivable market and aftermarket. (K.R.B. at

29-35.) Again, the district court did not consider what markets are relevant to this tying case, *or* what degree of market power ("ability to force") must be demonstrated, but merely "[a]ssum[ed] without deciding that such a market [for service] can be found to exist and that Kodak has market power in it," and that "Kodak has, of course, a natural monopoly over the market for parts." (Excerpts, p. 70, ll. 22-23; p. 71, ll. 1-2; A.O.B. at 37.) Worse yet, the lower court totally misapprehended plaintiffs' argument that a *Digidyne* economic lock-in enhanced Kodak's "ability to force" here. (A.O.B. at 33-35.) However, that court *did* make a finding of fact, favorable to plaintiffs and unchallenged by Kodak on appeal, that Kodak equipment owners tend to retain their equipment "for its economic life." (Excerpts, p. 70, ll. 4-7.) That finding sinks Kodak's "interbrand competition at the equipment level" argument, upon which it bases its *entire* argument that it has no market power in the parts or service aftermarkets. The only view consistent with reality is this Court's recognition in *Dimidowich* that "an owner of broken- . . . micrographic equipment is indifferent to people who can service [other brands of] machines. The owner's *only option* is to request service from [one who services its brand]." Because, *on this record*, there is an *unchallenged* finding that Kodak owners tend to keep their equipment for its economic life, Kodak's suggestion "that Kodak customers can switch to competing equipment if Kodak tried to raise the price of parts or service" *must* be rejected. (K.R.B. at 30.) Kodak has failed to muster any plausible argument showing lack of market power in parts or service, and determination of whether it can be made by the trier of fact on remand.

Contrary to the suggestion in Kodak's brief, *General Business, supra,* will not assist Kodak in showing a lack of market power upon remand. In *General Business,* the court recognized that it was prospective *new* "computer system *buyers,*" *not* "locked-in" computer "*owners*", who "quickly could shift to other [computer] sellers" if supracompetitive prices arose for accessory parts. (699 F.2d at 972.) In *General Business,* the equipment was small computers, vastly less expensive than the Kodak copying and microfilm systems at issue here. (The same is true of *Bushie's* dictating machines and the money handling machines in *Calculators Hawaii, Inc. v. Brandt, Inc.,* 724 F.2d 1332 (9th Cir. 1983).) In such inexpensive-equipment situations, interbrand competition at the equipment level may permit a "quick change" to competing manufacturers if parts and service prices are raised to supracompetitive levels. That is not the case here.

In the case at bar, the relevant inquiry is *not* the market faced by all *prospective* equipment *buyers,* who can shun an equipment seller whose parts and service are priced too high, but rather the market faced by *current* Kodak *owners* of relatively expensive equipment, who on this record *keep* their equipment for its economic life and *do not* and *cannot* economically switch, precisely as recognized in *Dimidowich.* In such a situation, this Court in *Dimidowich,* upon which Kodak principally relies, recognized that:

> [A]n *owner* of broken B&H micrographic equipment is indifferent to people who can service Kodak or 3M machines. If the *owner's* only option is to request service from B&H . . . *that is obviously the market the owner faces.*

(803 F.2d at 1481 n.3.) (Emphasis supplied.)

This is precisely the service (and parts) market faced by Kodak *owners* here. This was emphasized in plaintiffs' opening brief (A.O.B. at 41-42 and 44), but Kodak has made and can make no "response" to it. Kodak never squarely faces and addresses this fundamental fact: The owner of large and expensive Kodak equipment such as copy or micrographic machines *will not abandon that equipment in response to monoplistic or supracompetitive service prices* by Kodak, and *will not replace it immediately with an interbrand competitor.* The relatively small additional costs of such service would not justify the huge cost of replacement. The owner will simply pay Kodak what it asks for the service. This is the simple reality of this case that Kodak cannot rebut, and which destroys Kodak's "interbrand competition" argument.

Nor can (or does) Kodak respond to the authority cited in plaintiffs' opening brief that where, as here, the manufacturer is vertically integrated, it is appropriate "to limit the relevant market to [that] single firm's products." *Spectrofuge Corp. v. Beckman Instruments, Inc.,* 575 F.2d 256, 282 (5th Cir. 1978), *cert. denied,* 440 U.S. 939 (1979); A.O.B. at 39-40. After citing a number of cases, including this Circuit's *Bushie* decision, the *Spectrofuge* court concluded, in language which Kodak concedes by its long, loud silence:

> Analysis of these cases reveals that such a limited [single-brand] market would be appropriate when, for example, the vertically integrated manufacturer uses his dominant position *at one level of competitive activity to eliminate competition at another level.* . . .

(575 F.2d at 282.) (Emphasis supplied.)

These unchallenged *Dimidowich* and *Spectrofuge* holdings that single-brand markets may exist in parts and service, coupled with the *Digidyne* economic lock-in enhancement and the district court's *Digidyne*-consistent finding of fact that Kodak owners keep their equipment for its useful life and are not free to "quickly switch," as well as this Court's pinpointing of the realities faced by an owner of equipment needing service in *Dimidowich*, all provide irrefutable authority that plaintiffs have established, or at least will be able, on remand, to establish, separate service and parts markets and show Kodak's "ability to coerce" therein.

H. Kodak Has Not Acted Unilaterally.

Kodak's final suggestion that there can be no Section 1 violation here because its actions were "unilateral" is wrong on both the facts and the law. Here, Kodak has bilateral agreements with its equipment owners, expressly set out in its "Terms of Sale," that it will sell parts to users "who service *only* their *own* Kodak equipment." (Excerpts, p. 39, emphasis supplied; A.O.B. at 22.) This express restriction in Kodak's customer contracts is precisely the opposite of the facts in the case Kodak cites, *Spectrofuge, supra,* where defendant Beckman's contracts contained "not one word" relating to the alleged tying arrangement and where "Beckman parts were available to anyone, irrespective of who serviced the instruments." 575 F.2d at 288 & n. 97. Kodak's contracts with its customers clearly constitute "contracts . . . in restraint of trade" and are bilateral agreements, not unilateral action. As the *Spectrofuge* court noted, tying arrangements are not "unilateral activity":

> The other cases cited by Spectrofuge involved tying arrangements. These decisions are *totally irrelevant* [to defendant's argument that its action was unilateral].

(575 F.2d at 288, emphasis supplied.)

Plaintiffs have demonstrated Kodak's tying arrangement with equipment owners apart from Kodak's refusal to deal with ISOs. The district court did not recognize the tie. Plaintiffs' unrebutted showing below demonstrates outright the illegality of Kodak's tie, or at the very least, raises genuine issues of triable fact. The summary judgment must be reversed and the case remanded with findings regarding the elements of the tie-ins plaintiffs have established.

III. UNDER THE SHERMAN ACT, SECTION 2, KODAK, WITH MONOPOLY POWER OVER WHOLESALE PARTS, MAY NOT REFUSE TO DEAL WITH ISOS WHO COMPETE FOR RETAIL SALES OF SERVICE IN ORDER TO DESTROY THEM.

A. There Are Limitations on Colgate's Refusal To Deal Dicta.

Kodak's responsive brief ignores plaintiffs' well-accepted exceptions to the dicta in *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919), that the Sherman Act allows unilateral refusals to deal, even though this dicta forms the cornerstone of Kodak's whole case and its reliance on *Bushie, Calculators Hawaii* and *Dimidowich*. (K.R.B. at 16.) In quoting the *Colgate* language, Kodak purposely (and misleadingly) omits key language of the Supreme Court:

> *"[I]n the absence of any purpose to create or maintain a monopoly,* the [Sherman] [A]ct does not restrict the long recognized right of trader or manufacturer . . . freely to exercise his own independent discretion as to parties with whom he will deal. . . . "

250 U.S. at 307. (Emphasis supplied.) This language was precisely the language emphasized by the Supreme Court in finding a Section 2 violation in *Lorain Journal v. United States,* 342 U.S. 143, 155 (1951), where the defendant Lorain Journal unilaterally refused to deal with persons who bought advertising from a competing radio station. It was again quoted and relied upon by the Supreme Court in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.,* 472 U.S. 585 (1985) in finding a Section 2 violation for a unilateral refusal to deal.

The inquiry is therefore not whether Kodak may unilaterally refuse to deal, but whether there is an "absence of *any* purpose to create or maintain a monopoly" in the relevant market.

B. The Essential Facility Doctrine of Otter Tail And Elimination of Rivals in Lorain Journal Apply.

Violations of Section 2 of the Sherman Act have been found when a firm like Kodak, which has monopoly power at one level of a chain of distribution (wholesale parts), refuses to deal with firms at another level of the distribution chain (retail service) in order to drive those firms from business, so that the monopolist can integrate vertically and achieve a monopoly at both levels. The Supreme Court found a Section 2 violation under these circumstances in *Otter Tail Power Co. v. United States,* 410

U.S. 366 (1973). See also *Eastman Kodak Co. v. Southern Photo Materials Co.,* 273 U.S. 359, 375 (1927) (Kodak's monopoly in wholesale photographic supplies found to violate Section 2 where Kodak refused to sell supplies at wholesale to Southern Photo which competed with Kodak at retail).

In *Otter Tail,* the Supreme Court determined that Otter Tail, which had a monopoly over wholesale electric power, violated Section 2 by (1) refusing to sell power at wholesale to municipal power companies which competed with Otter Tail for retail sales of the power, and by (2) refusing to "wheel" electricity so as to let the municipal power companies buy at wholesale from others. The Supreme Court found that Otter Tail had violated Section 2 by this refusal to deal because it "sought to substitute for competition anticompetive uses of its dominant economic power." 410 U.S. at 380.

Kodak is engaged in the same type of business activity that *Otter Tail* found illegal. Kodak possesses admitted monopoly power over the tens of thousands of copier and micrographic equipment replacement parts it makes or has made. Plaintiffs cannot begin to afford to dupicate all of these parts, as they would be required to do in order to offer service if the parts are not available through Kodak. Kodak seeks to "substitute for [the existing] competition" in retail service of copier and micrographic equipment "anticompetitive uses of its dominant economic power" over plaintiff ISOs – i.e., to put the ISOs out of the business of competing with Kodak through its dominant economic power over parts. Kodak has not addressed,

and cannot overcome, the *Otter Tail* result and its exception to the blanket "refusal to deal" rule, recognized by *Colgate* and raised by plaintiffs in their opening brief.

In *Lorain Journal, supra,* the Supreme Court also found a violation of Section 2 of the Sherman Act. The Lorain Journal, a newspaper, was the only local business disseminating news and advertising in Lorain, Ohio. In order to eliminate its small competitor, a radio station established in a nearby community, the Lorain Journal refused to sell advertising to persons who also brought advertising from its electronic competitor. Kodak is engaging in exactly the same practices with regard to equipment owners who employ ISOs: it refuses to sell them parts. Such a unilateral refusal to deal is a violation of Section 2 of the Sherman Act under the exception noted in *Colgate*.

C. Pacific Coast Agricultural Export Assn. Requires The Finding Of A Section 2 Violation.

Likewise, Kodak has failed to address the Ninth Circuit case of *Pacific Coast Agricultural Export Assn. v. Sunkist Growers, Inc.*, 526 F.2d 1196 (9th Cir. 1975), *cert. denied* 425 U.S. 959 (1976), advanced by plaintiffs in their opening brief. There, Sunkist, with monopoly power over the wholesale supply of oranges, was found by the Ninth Circuit to violate Section 2 of the Sherman Act by its refusal to deal with plaintiff, to whom it had sold in the past, but who now competed with it for retail export of oranges to Hong Kong. Such a refusal to deal was found to violate Section 2 because "Sunkist's control of supply was employed to extend its monopoly into distribution."

526 F.2d at 1204. Kodak similarly, after initially selling copier and micrographics parts at wholesale to ISOs and others, has decided to extend its monopoly over parts into a monopoly over retail service to customers. Kodak has not mentioned *Pacific Coast Agricultural Export Assn.* because it cannot without conceding that its blanket "refusal to deal" rule does not control this case.

D. The Factors Considered In Aspen Dictate A Finding That Kodak's Actions Are Predatory.

In *Aspen, supra,* the Supreme Court considered another species of limitation on the "refusal to deal" rule when it considered the circumstances under which a firm with monopoly power has a duty to continue an existing joint-marketing arrangement with a smaller competitor. The Supreme Court found the defendant's refusal to deal in *Aspen* "a decision by a monopolist to make an important change in the character of the market," and, *coupled with* substantial impact on competitors and consumers as well as suspect business reasons given by the defendants, determined that defendants' actions were exclusionary. 472 U.S. at 604.

Kodak, by its refusal to sell parts to ISO competitors, when it *had* sold parts in the past, is, like *Aspen*, effecting "an important change in the character of the market" – it is eliminating ISOs nationwide and monopolizing a formerly competitive market for service. Like the *Aspen* Court, this Court should also place substantial weight on the adverse impact of Kodak's refusal to deal with its competitors (elimination of ISOs), on the "impact on consumers" (supracompetitive prices for service and lower

quality service), and on "whether [Kodak] has impaired competition in an unncessarily restrictive way" (rejection of sensitive pricing of parts as a means to recover investment). 472 U.S. at 605.

In attempting to distinguish *Aspen*, Kodak first trots out the old "interbrand competition" argument – that it "lacks market power in the copier and micrographics *equipment markets*." (K.R.B. at 38, emphasis supplied). This obviously misses the mark by far, since the product which Kodak refuses to sell (Kodak parts) and the service market it seeks to monopolize are the relevant markets, *not* the market for the new sales of Kodak equipment. In the cases relied on by plaintiff, the monopoly was measured by the markets for the product defendant refused to sell and the market sought to be monopolized: *Otter Tail* (local wholesale electric power market and power lines/retail power sales); *Pacific Coast Agricultural Export Assn*. (orange supply in Arizona and California/retail sales to Hong Kong), and *Aspen* (Aspen's ski lifts/Aspen area downhill skiing).

If Kodak prevails in its argument that wherever interbrand competition exists for one product, any second product or service associated with the first product (over which second product the company may have a monopoly or market power) may be illegally tied, or may be put to other "anticompetitive uses," then *Otter Tail*, *Pacific Coast Agricultural Export Assn*. and *Aspen* would have been decided differently.

Kodak attempts to misstate plaintiffs' position by asserting that "*Aspen* does not stand for a broad proposition that monopolists who choose to deal with their

competitors can never change their minds," and to isolate *Aspen* as an aberration based on strange facts, are to no avail. (K.R.B. at 38.) *Aspen* is another species of the *Otter Tail* principle that a monopolist does not have carte blanc to refuse to deal with a competitor in order to put that competitor out of business, *particularly where* there are existing dealings between them. Such prior dealings show *prima facie* that the monopolist had a business rationale to deal with its competitor in the first place and make suspect his subsequent refusal to deal. This was the case in *Otter Tail*, *Pacific Coast Agricultural Export Assn.*, and *Aspen*.

It was not the case in *Oahu Gas Service, Inc. v. Pacific Resources, Inc.*, 838 F.2d 360 (9th Cir. 1988), relied on by Kodak. In that case, plaintiff and defendant both bought propane from a third party, Chevron, and the issue was whether Pacific could be required to modify its refinery to permit production of propane for sale to plaintiff. In *Oahu* the Ninth Circuit found that Pacific's argument that modification of its refinery would be unprofitable was the legitimate reason for Pacific's refusal to do so, and that its refusal should not result in antitrust liability. Kodak not only is *not* being asked to modify its production of Kodak replacement parts for plaintiffs, it has supplied all such parts in the past (at a profit), and it will have to supply the same number of parts for all machines it sells whether it has a monopoly on service or whether it shares the service market with ISOs. Kodak does not and cannot make a claim that its sales of replacement parts are unprofitable as a business since it sells many such parts to ISOs at 100% more than to its own customers. In short, Kodak has not shown that its refusal to deal with

ISOs (as to which refusal there is substantial evidence of an exclusionary intent) was motivated by legitimate business reasons.

E. Kodak's Alleged "Business Reasons" For Its Parts Policy Change Are Shams and Do Not Prevail Over Its Predatory Intent And The Injury to Competition.

The burden on Kodak under these circumstances is a heavy one - to show the validity of new "business reasons" for its refusal to deal as a monopolist, and those reasons must outweigh the clearly anticompetitive intent. This burden is placed on Kodak because (1) there has been a course of dealings and prior sales to such competitors; (2) the new policy is "an important change in the character of the market"; (3) there is a substantial impact on service competitors; and (4) there is a substantial impact on service consumers. *Aspen*, 472 U.S. at 605.

Kodak proffers three basic reasons for the new and radical changes in its parts policies (Kodak's statement that "[n]either is there any evidence here that Kodak made a significant change in its policy" (K.R.B. at 41) is just plain untrue). Kodak claims the policy changes were motivated by: (1) "Promoting Interbrand Competition" (K.R.B. at 9); (2) "Reducing Inventories" (K.R.B. at 11); and (3) "Not Supporting Free Riding" (K.R.B. at 12). None of these reasons is valid.

Kodak's first argument is that the promotion of interbrand competition will be served by Kodak's actions, even though - or perhaps because - such actions would put all Kodak's service competitors out of business.

Kodak argues that a monopoly by Kodak would result in "[g]ood service" which "enhances Kodak's ability to sell equipment." (K.R.B. at 9.) This is a tenuous proposition at best. The fundamental tenets of free competition under the Sherman Act, expressed by the Supreme Court in *Northern Pacific, supra,* in fact negate such a proposition:

> The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the *lowest prices, the highest quality* and the greatest material progress . . .

356 U.S. at 4 (Emphasis supplied.)

Competition for service of Kodak machines, not monopoly, will yield the lowest prices and the highest quality of service. Indeed, plaintiffs' evidence (A.O.B. at 7, 17) shows that ISO competitors both lowered the price and increased the quality of service for Kodak machines - as competition is supposed to do. The availability of high quality, low-cost service, not the requirement that service be bought from a monopolist, would best increase interbrand competition.

Kodak's second argument is that by refusing to sell replacement parts for Kodak equipment to ISOs (parts which only Kodak can supply), it would "reduce inventories" required for such parts. This argument is nonsensical. The total population of Kodak machines requires a certain number of replacement parts. If Kodak puts all ISO competitors out of business and establishes a 100% monopoly on service for this total population of

Kodak machines, it will have to supply the same number of parts that it now does – i.e., the parts for this total population of Kodak machines. The demand for Kodak replacement parts and the inventories to supply those parts will not vary if Kodak provides 100% of the service, or if Kodak shares that service with ISO competitors. Kodak will therefore not be able to reduce inventories at all, and in reality probably does not intend to.

The real rationale for Kodak's cutting off of ISOs' parts is its pique at ISOs competing with it for service and taking away Kodak service customers. It determined to do everything in is power not to help them, and to put them out of business:

> Kodak management felt it made no sense to subsidize the efforts of these firms by manufacturing or purchasing and, at Kodak's expense, maintaining inventories of parts for their use.

(K.R.B. at 12.)

This admission forms the basis for Kodak's third argument that "Kodak does not want to help the ISOs take away service revenues from Kodak." Kodak argues that to require it to sell replacement parts to ISOs would sustain or create "free riders". Yet Kodak utterly fails to explain why ISOs – who often pay twice as much for parts as some of Kodak's other customers – are "free riding," except for the lame assertion that it has some sort of "birth right" to monopolize service stemming from its investment in the manufacture of equipment. The so-called "free rider" authority Kodak cites (K.R.B. at 37) not only has no application here, it has been badly perverted by Kodak. In *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), primarily relied upon by Kodak, the

Supreme Court dealt solely with the distribution of new T.V. sets manufactured by Sylvania. The sale of service and parts was not even at issue in *Sylvania*, only the sale of the new equipment. In fact, the so-called "free rider" effect in *Sylvania* referred to the situation where some distributors of the new T.V. sets *refused to provide service* and repair facilities for such equipment and merely sold the equipment, avoiding any responsibility or costs downstream for its repair. 433 U.S. at 55. The case at bar obviously presents no such situation whatsoever. *Sylvania* and its progeny do not require ISOs, in order to compete with Kodak on service, to first manufacture the equipment they repair.

Kodak's three alleged "business reasons" are shams. They are clearly designed to try to cloak Kodak's predatory and exclusionary conduct, in violation of Section 2 of the Sherman Act, as reasonable and competitive conduct. The reasons proffered by Kodak fall far short of the business reasons accepted in *Oahu* (that a manufacturer cannot be forced to *begin unprofitable production* to supply a competitor) or in *Olympia Equipment Leasing Co. v. Western Union Telegraph Co.*, 797 F.2d 370 (7th Cir. 1986) (that Western Union cound not be forced *to supply a competitor with its sales force* when the competitor could easily supply itself). In fact, in *Oahu*, plaintiff Oahu was able to and did obtain its propane from an alternate source, Chevron, to compete with Pacific Resources. In *Olympia Equipment* other competitors were able to establish their own sales forces and were able to remain in competition without Western Union's assistance. The undisputed evidence here is that plaintiff ISOs cannot manufacture the tens of

thousands of Kodak replacement parts necessary to stay in competition with Kodak.

The Ninth Circuit's language in *Oahu* that the "affirmative duties" of a monopolist to aid its competition are not absolute and "arise only when there is no justification for refusing aid to a competitor" must be read in light of the principles of *Otter Tail, Aspen* and *Pacific Coast Agricultural Export Assn.* It is clear that a number of factual issues go into determining whether the refusal to deal of a monopolist is primarily exclusionary – designed to achieve a monopoly at another level of distribution – or is justified by *legitimate* and not sham business reasons. The determining factor is not, as Kodak suggests, whether there is some business reason proffered by the defendant, but whether, on balance, the exclusionary reasons or the proffered business reasons predominate.

In *Aspen*, the Supreme Court in concluding that the action there was predominately exclusionary, considered: (1) the prior willingness of the defendant to deal; (2) its course of dealings with plaintiff; (3) whether the change by defendant was an important change in the character of the market; (4) the impact on competitors; (5) the impact on consumers; and (6) whether the actions were unnecessarily restrictive of competition, *as well as* whether there were independently valid business reasons for Aspen's refusal to deal. On each of these points Kodak, as a monopolist in Kodak replacement parts, has failed to show that its refusal to deal with ISOs was not predominately exclusionary and illegal under Section 2 of the Sherman Act, as construed in *Otter Tail, Lorain Journal, Aspen* and *Pacific Coast Agricultural Export Assn.*

CONCLUSION

For the foregoing reasons, and those set out in Appellants' Opening Brief, the summary judgment of the district court should be reversed, and this case should be remanded with instructions to make findings that plaintiffs have established, or have at least raised triable issues of material fact with regard to: (1) the elements of *per se* tying arrangements in violation of Section 1 of the Sherman Act; and (2) the elements of a monopolist's predatory refusal to deal with competitors in violation of Section 2 of the Sherman Act.

Dated: November 29, 1988

Respectfully submitted,

By: /s/ James A. Hennefer
JAMES A. HENNEFER

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

NO. 88-2686

IMAGE TECHNICAL SERVICES, INC., et al.,
Plaintiffs-Appellants,
v.
EASTMAN KODAK COMPANY,
Defendant-Appellee.

Appeal from the United States District
Court for the Northern District
of California
Case No. C-87-1686-WWS

Honorable William W. Schwarzer
Judge Presiding

PETITION FOR REHEARING AND SUGGESTION
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Defendant-Appellee.

Appeal from the United States District
Court for the Northern District
of California
Case No. C-87-1686-WWS

Honorable William W. Schwarzer
Judge Presiding

PETITION FOR REHEARING AND SUGGESTION
FOR REHEARING *EN BANC*

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INTRODUCTION

No other court has ever held that a vertically integrated equipment manufacturer which faces active competition from other manufacturers may violate the antitrust laws *per se* by not selling repair parts to aftermarket competitors unwilling to develop their own parts supply sources. All prior decisions, including those of this Court, recognize that as a matter of irrefutable economic principle, it is impossible to exercise market power in a derivative aftermarket without market power in the primary interbrand equipment market. As Judge Wallace's dissent shows, imposing a duty to sell parts would protect competitors, not competition.

The majority opinion expressly acknowledges both the logic of this principle and the fact, conceded by appellants, that Kodak has no market power in either of the interbrand equipment markets relevant to this case. Opinion at 3637, 3643. However, the majority then proceeds to ignore the principle. Relying on the possibility that unidentified "market imperfections" and unknown "other factors" might somehow suspend this principle, it reverses summary judgment. *Id.* at 3635, 3637.

The majority's opinion raises at least two fundamental issues, one of procedure and one of substance. Procedurally, the majority misperceives the role of economic analysis in ruling upon summary judgment motions in antitrust cases. The Supreme Court squarely held in *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986), that "if the claim is one that simply makes no economic sense," plaintiff's burden to survive summary judgment increases. This Court has consistently followed that rule. Yet the majority. after acknowledging that it was *Kodak's defense* that made economic sense, reversed summary judgment based on the unsupported — and certainly unexplained-possibility that theory might not mirror reality. Opinion at 3636, 3643. This major change in the Court's approach to summary judgment warrants rehearing.

Substantively, the majority's opinion has profound and distinctly anticompetitive effects. By making the large investments of money, talent and energy required to compete in the interbrand markets for copiers and micrographics equipment, Kodak has undeniably enhanced competition. Antitrust policy should and always has encouraged such investments. And because no one disputes that Kodak faces fierce competition and lacks market power, there is no danger that Kodak could act in a way that would harm consumers.

Accordingly, imposing a duty on Kodak to support aftermarket service competition against itself cannot be justified on the ground that it protects consumers from Kodak. Rather, imposing such a duty *penalizes* Kodak for having made the investments which created the "Kodak service" aftermarket in the first place. It says to Kodak,

and by extension to all equipment manufacturers, that developing a successful product carries an antitrust penalty. That is a rule that is anti-investment, anti-innovation and ultimately anticompetitive. Small wonder that until now, no court has ever embraced it.

Kodak petitions the Court for rehearing and, alternatively, suggests a rehearing *en banc*. In counsel's judgment, rehearing is required since the majority opinion overlooks and misapprehends key points of fact and law. Federal Rule of Appellate Procedure 40. Those specific points, discussed below, are overlooking the *Matsushita* standard for summary judgment, misreading *Jefferson Parish Hospital Dist. No. 2 v. Hyde*, 466 U.S. 2, 15 n. 24 (1984), failing to follow precedents relying on the economic principle presented by Kodak, failing to describe any alternative economic analysis, overlooking this Court's prior decisions that unilateral refusals to sell parts are lawful, and ignoring unrefuted evidence that there are no entry barriers to any potential parts market, that parts are not an essential facility and that Kodak's high quality service justification is genuine, Kodak requests rehearing to affirm the judgment below in favor of Kodak on the *per se* tying and monopolization claims.

I. THE PER SE TYING CLAIM

A. There Is No Genuine Issue Regarding Kodak's Lack Of Market Power In The Market For Parts.

Appellants concede (and the majority opinion agrees) that there is fierce competition in the interbrand markets for copiers and micrographics equipment and that Kodak lacks any ability to restrain competition in the interbrand

markets. A.O.B. at 44-45; A.R.B. at 11-13; Opinion at 3634. With that concession, as Judge Wallace demonstrates, the "economic logic of Kodak's position [cannot] be overcome." Dissent at 3647. Kodak can neither leverage power into aftermarkets, nor use any power it somehow may have in the aftermarkets without compromising its interbrand market position.[1] That logic disposes of the *per se* tying claim as a matter of law.

1. Unknown "market imperfections" cannot support a per se tying claim.

The majority misapprehends this market power issue. It concedes, as it must, that a tying arrangement is unlawful only if there is market power in the tying product market (here, in the majority's formulation, a "Kodak parts market"). Opinion at 3631, 3633. And it concedes that, in principle, Kodak should not have the required market power given its lack of market power in the interbrand equipment market. *Id.* at 3634. But then the majority brushes aside this principle with an approach that even appellants did not propose.[2] It suggests that

[1] The Kodak brand parts and service aftermarkets are not separate from the interbrand market; nor does Kodak concede that its practices constitute a tying arrangement. Appellee's Brief at 26-29.

[2] Appellants never explain, theoretically or factually, how the economic principle could be otherwise. Instead, in reliance on the much criticized *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336, 1339 (9th Cir. 1984), *cert. denied*, 473 U.S. 908 (1985), they argue that although Kodak's theory works for new customers, it may not for owners of older equipment who are "locked-in." A.R.B. at 12-13. *Digidyne* does not support appellants. *See* Appellee's Brief at 32-34.

"market imperfections can keep economic theories about how consumers will act from mirroring reality." *Id.* at 3635-36, *citing Jefferson Parish Hospital Dist. No. 2 v. Hyde*, 466 U.S. 2, 15 n. 24 (1984). The majority opinion never identifies any such imperfections, and thus the possibility that they exist should not suffice to overcome summary judgment. *See Richards v. Neilsen Freight Lines*, 810 F.2d 898, 902 (9th Cir. 1987) (Kennedy. J.) ("It is the record made on summary judgment that controls, not that record plus speculative inferences. . . . ").

Worse, however, the majority completely misreads *Jefferson Parish*. *Jefferson Parish* holds that market imperfections do *not* suffice to prove tying market power: "While these factors may generate 'market power' in some abstract sense, they do not generate the kind of market power that justifies condemnation of tying." 466 U.S. at 26-27 (footnote omitted). Therefore, even if the majority could identify specific imperfections in the copier and micrographics equipment markets (as was done in *Jefferson Parish*, at 27), they could not be the basis for a finding of tying market power.

To bootstrap lack of market power into market power, the majority next formulates an illogical equation: "Some strength in the interbrand market, although short of actual market power, can combine with other factors to yield power in an after-market." Opinion at 3637. In algebraic form, the majority's formula is:

LESS THAN MARKET POWER + UNKNOWN FACTORS = MARKET POWER

That formula is fatally flawed. No court has ever before suggested that something less than market power will

suffice to establish a *per se* tying claim. No court has ever before suggested that some unidentified factor can turn lack of market power into market power. Indeed, the very authority cited by the majority, *Jefferson Parish*, explicitly holds that market power is required and that even identified "market imperfections" do not eliminate the requirement for market power. 466 U.S. at 27. This Court has always adhered to that rule. *E.g. Mozart Co. v. Mercedes-Benz of N. Am., Inc.*, 833 F.2d 1342, 1345 (9th Cir. 1987), *cert. denied*, 109 S. Ct. 179 (1988). The majority opinion errs by misreading *Jefferson Parish* and by expressly lowering the standard required to prove an unlawful tying arrangement.

Since "market imperfections" are not enough to make up for lack of market power, the majority's citation to evidence of events in the assumed aftermarket (opinion at 3636) is also unavailing. First, the majority's evidence does not support a finding of market power and is, in fact, consistent with Kodak's position. As Judge Wallace notes, that evidence is entirely consistent with the concept that Kodak can only charge supracompetitive prices for services in the suicidal short run and at risk of losing its position in the far more important interbrand market. Dissent at 3645-46. It is also consistent with the concept that freeriding ISOs who do not bear the costs of establishing and maintaining parts inventories may be able to outbid those, like Kodak, who make the investment.

Second, the evidence mustered by appellants is inadmissible, isolated and incidental at best.[3] It is not

[3] The majority first cites evidence that Kodak charges up to twice as much for inferior service. Opinion at 3636. The

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evidence that overcomes either the economic principle that competition in the interbrand markets controls or the fact that Kodak's activities have enhanced interbrand competition.

2. The majority opinion is inconsistent with Matsushita.

The shortcomings of appellants' evidence are made even clearer by contrasting this case to *Matsushita*. *Matsushita* held that plaintiffs who present claims that make "no economic sense" must meet strict evidentiary

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actual "evidence is" an unauthenticated Kodak document which recites only hearsay statements from a third party about pricing and concludes that Kodak has the "best service organization" for which customers are "sure[ly]" willing to pay a "premium." Record, No. 41, Hennefer Decl. Ex. L (p. 59 of appellants excerpts). Next the majority cites evidence that competition from ISOs in some instances drove down Kodak's service price. But appellants cited no such evidence in their briefs. The record shows only hearsay references to two offers by Kodak to lower prices. Record, No. 40, Arnold Decl. ¶¶ 26, 30. Finally, the majority cites evidence that some owners of large Kodak equipment may pay higher prices for Kodak service rather that switch to a competitor's equipment. That "evidence" consists of conclusory, hearsay statements in appellants' declarations to the effect that some owners of older micrographics equipment are "locked in." *See* Hernandez Decl. ¶¶ 40-47, Welch Decl. ¶ 17; Kastner Decl. ¶¶ 5-8. But, regardless of appellants' lock-in theory, this evidence is limited to older micrographics equipment and, as appellants concede, Kodak continues to sell parts to ISOs for older micrographics equipment.

standards to overcome summary judgment.[4] 475 U.S. at 587. The Supreme Court rejected evidence that was far more substantial than the evidence here.

The *Matsushita* Court rejected an expert's opinion that the alleged conspirators had depressed prices in the United States and sold goods at substantial losses. 475 U.S. at 594 n. 19, 600-03. The Supreme Court found that the expert's evidence of below-cost pricing had "little probative value in comparison with the economic factors . . . that suggest that such conduct is irrational." *Id.* at 594 n. 19. The dissent in *Matsushita* claimed that "[n]o doubt the Court prefers its own economic theorizing" to

[4] The majority opinion finds "logical appeal" in the economic principle cited by Kodak, but "cannot say that this theory mirrors reality." Opinion at 3634. In contrast, the Supreme Court in *Matsushita* found that economic principles are not just theories; they are "economic realities" -- sufficient to support summary judgment and overcome some contrary evidence. 475 U.S. at 594-95, n. 19. Economics do matter in antitrust cases. As this Court stated last Wednesday, "like all antitrust cases, this one must make economic sense." *U.S. v. Syufy Enterprises*, 1990 U.S. App. Lexis 7396 at 6-7 (9th Cir., No. 89-15475, May 9, 1990). *See also Atlantic Richfield Co. v. USA Petroleum Co.*, 1990 U.S. Lexis 2543 (Supreme Court. No. 88-1668. May 14, 1990) (reversing divided decision of this Court in context of Section 1 summary judgment); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 723-31, 735-36 (1988) ("[R]esting [its] decision upon the foregoing economic analysis"); *The Jeanery, Inc. v. James Jeans, Inc.*, 849 F.2d 1148, 1156-57 (9th Cir. 1988) (Recent Supreme Court decisions "reflect a more sophisticated use of economic analysis in antitrust cases than has previously been seen. [Citation omitted.] In line with this economic awareness, a court should be less concerned with subjective notions of motive and more concerned with the economic effect of challenged conduct.")

the expert's analysis (*id.* at 603), but the majority in *Matsushita* recognized that its economic theories were "economic realities" and so controlled. *Id.* at 595.

In this case there is no expert analysis. There is no competing economic theory. The isolated evidence cited by the majority does not support the inferences drawn from it. That evidence is certainly insufficient to rebut the conceded economic logic based on facts that are also conceded. As in *Matsushita*, where the Supreme Court relied on economic logic to support summary judgment and to reject contrary evidence and expert opinion, economics should control the outcome here. Since, as a matter of economic reality, Kodak necessarily cannot have market power in the derivative market for parts, appellants' *per se* tying claim fails.

3. The majority's opinion conflicts with the controlling authorities of this Court and other courts of appeals.

This and other courts have repeatedly found that interbrand equipment competition prevents a finding of market power in a derivative aftermarket. The majority fails to distinguish those cases, even the three on which Kodak relied most: *General Business Systems v. North American Philips Co.*, 699 F.2d 965, 977 (9th Cir. 1983); *Grappone, Inc. v. Subaru of New England, Inc.*, 858 F.2d 792, 794 (1st Cir. 1988) and *Parts and Electric Motors, Inc. v. Sterling Electric, Inc.*, 866 F.2d 228, 234-37 (7th Cir. 1989) (Posner. J., dissenting).

The majority says that plaintiffs in *General Business Systems* presented no facts from which market power in

the computer market could be inferred.[5] Opinion at 3636. That certainly does not distinguish it from this case. Here, appellants concede the same thing. Opinion at 3634 n. 3 ("Appellants do not dispute Kodak's assertion that it lacks market power in the interbrand markets.") And as Judge Wallace notes, once that is conceded market share has no significance. Dissent at 3647. Moreover, the majority misreads *General Business Systems*. There was substantial evidence that the tied product in that case, magnetic ledger cards ("mlcs"), was priced supracompetitively and that mlcs constituted a separate market. 699 F.2d at 973. But the "primary" point was that, despite that evidence, "Philips had little or no power to raise the price of its mlcs without reducing its profits because any such increase would diminish sales of its computer system . . . ." *Id.* at 972. If anything, summary judgment in this case follows *a fortiori* from General Business Systems.

The majority tries to distinguish *Grappone* by saying "Kodak has tied parts to service, not equipment to parts." Opinion at 3634. That is a distinction without a difference. Both the parts market and the service market (if they are separate) are derivative of the equipment market. If, as the majority suggests, power cannot be transferred from the equipment to the derivative parts market, then power cannot be transferred to the derivative service market. Thus, just as competition in the primary

[5] The majority also says that there is no evidence that Philips was the exclusive source of the tying product, service for its computers. Opinion at 3636-37. The lack of evidence regarding the uniqueness of Philips' service played no role in the Court's determination that the aftermarket for mlcs could not be separated from the interbrand market. 699 F.2d at 972.

interbrand market prevents Subaru from charging supracompetitive prices for parts (*Grappone*, 858 F.2d at 798), it prevents Kodak from charging higher prices for service.

As to Judge Posner's dissent in *Parts and Electric Motors*, the majority only contrasts the relative strengths of Kodak's and Sterling's shares in the interbrand markets. Opinion at 3637. But again the controlling issue, no market power in the primary market, is conceded. As Judge Wallace states, given that concession, it makes no difference what defendant's market share is. Dissent at 3647. The principle that Judge Posner explained and Judge Wallace followed still holds: Kodak cannot, in any non-trivial sense, exercise market power in an aftermarket. 866 F.2d at 236; Dissent at 3646.

B. Kodak's Practices Are Unilateral Refusals To Deal.

The centerpiece of Kodak's position before this Court was that its practices fit a long line of cases holding that a manufacturer's unilateral refusal to sell replacement parts does not violate the antitrust laws. *Bushie v. Stenocord Corp.*, 460 F.2d 116, 120 (9th Cir. 1972); *Calculators Hawaii, Inc. v. Brandt, Inc.*, 724 F.2d 1332, 1337-38 (9th Cir. 1983); *Dimidowich v. Bell & Howell*, 803 F.2d 1473, 1478 (9th Cir. 1986), *modified*, 810 F.2d 1517 (1987). Prior to the majority opinion here, every court that reviewed a manufacturer's unilateral refusal to sell parts found it to be legal.

In discussing the tying claim, the majority overlooks Kodak's position and does not discuss these cases. It simply notes that Kodak did not act unilaterally since it

entered into "agreements" with its equipment owners that they could buy parts without service only if they were self-servicers. Opinion at 3639. The majority relies exclusively on Kodak "Terms of Sale" that contain an introductory statement that "[p]arts are stocked to meet the repair needs of . . . other users . . . who service only their own Kodak equipment." Record, No. 40, Hernandez Decl. Ex. C, p. 1 (p. 39 of appellants' excerpts). The majority misapprehends both the law and the evidence.

First, all of the above-cited cases involved the same kind of "agreements" between a manufacturer and its customers.[6] Nevertheless, all held that such vertical arrangements do not constitute unlawful concerted actions under the antitrust laws.

Second, the purported restriction adds nothing to appellants' claim, Kodak's practices are intended to limit sales of parts to ISOs only.[7] Presumably the majority has

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[6] *Bushie*, 460 F.2d at 120 ("[T]he effect of the agreement [between Stenocord and former Bushie employee] was to eliminate Bushie as a Stenocord dealer [who had been selling and servicing Stenocord dictating equipment]."); *Calculators Hawaii*, 724 F.2d at 1334 ("[A]greement between Brandt and Hallett . . . prevented Calculators, an office equipment distributor, from obtaining Brandt equipment or repair parts."); *Dimidowich*, 803 F.2d at 1475 (Bell & Howell "does not sell parts for resale *or for use* by independent companies that service and repair B & H equipment." (Emphasis added)).

[7] The record in this case is undisputed that Kodak's purported restriction has had no significant effect. As quoted by appellants. Kodak acknowledges that it "has no effective means to prevent direct equipment customers from purchasing parts, ostensibly to perform their own service, when in fact

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no problem with that practice as applied directly to ISOs, but seizes on the purported restriction on sales to others not to have ISO's install those parts. *See* Opinion at 3632 (relying on second half of *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1. 5-6 (1958) test). But attempting not to sell parts to ISOs indirectly is no more anticompetitive than the direct refusals to sell parts which have been found to be legal. Kodak has an unquestioned right to refuse unilaterally to sell parts to ISOs. That right should not be undercut by references to "agreements" that are nothing more than restatements of an intention to refuse to deal.

C. A Desire Not To Help ISOs May Justify Kodak's Practices.

One of the business justifications cited by Kodak in support of its practices was the desire not to help ISOs compete against it and take away service revenues. The majority opinion incorrectly holds, as a matter of law, that Kodak's desire not to support freeriding cannot be a valid business justification. Opinion at 3639.

This holding is based on the conclusion that Kodak's practices "create[] an entry barrier by requiring [ISOs] to

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they have an ISO service their equipment." A.O.B. at 23. Appellants admit that Kodak's restrictions are ineffective since it sells parts to "total strangers to Kodak with no association to micrographics machines at all (such as the 'China Hutch,' an English China Shop, or to non-existent individuals such as 'Remy Corgi,' a person's dog)." A.O.B. at 12. There is no reason to penalize Kodak for a practice that has no real effect.

enter two product markets simultaneously." *Id.* To the contrary, and as the majority notes elsewhere, Kodak denies that parts and service are separate markets. Opinion at 3632. Since the majority found the question of two markets to be "a disputed issue of fact." it cannot resolve the question against Kodak as a matter of law.[8]

Further, even if parts and service are separate markets, the majority cannot conclusively presume — as its "matter of law" holding does — that this alleged tying arrangement creates barriers to entry. Tying arrangements create entry barriers, if at all, only to the extent that such barriers exist in the *tying* product market.[9] This is the essence of *U.S. Steel Corp. v. Fortner Enterprises*, 429 U.S. 610, 617-18 (1977), where a prefabricated homes-to-credit tie was held not to be unlawful because the defendant lacked any cost advantage over its competitors in the tying product (credit) market. It was also recognized in Fortner Enterprises, Inc. v. U.S. Steel Corp., 394 U.S. 495, 505 n. 2 (1969), where the Court stated that tying is

[8] The correct analysis recognizes that parts are required to perform service, and are thus a necessary investment for any participant in any alleged service market. Kodak has made that investment; the ISOs decline to do so, and instead demand that Kodak supply their parts so that they can take service revenues away from Kodak. That is anticompetitive freeriding.

[9] *See Will v. Comprehensive Accounting Corp.*, 776 F.2d 665, 672 (7th Cir. 1985), *cert denied*, 475 U.S. 1129 (1986) ("If rivals may design and offer a similar package for a similar cost, there is no barrier, and without a barrier there is no market power."); *Tic-X-Press, Inc. v. Omni Promotions Co. of Georgia*, 815 F.2d 1407, 1420 (11th Cir. 1987); *Spartan Grain & Mill Co. v. Ayers*, 735 F.2d 1284, 1288 (11th Cir. 1984), *cert. denied*, 469 U.S. 1109 (1985).

unlawful "only when other competitors are in some way prevented from offering the [tying] product themselves."

Here, there is no evidence of barriers in the tying product market -- specifically, no evidence that appellants cannot manufacture or procure from independent manufacturers parts they could use to provide service on Kodak machines. Indeed, there is no evidence that appellants even tried to obtain parts from other sources. At most, appellants claim they cannot buy them from Kodak's own OEM suppliers. A.O.B. at 14. But their "evidence" was limited to hearsay statements that some parts could be obtained elsewhere at lower prices (*e.g.*, Record. No. 40. Damiani Decl. ¶ 21, Kastner Decl. ¶ 13), some at higher prices (*e.g.*, *Id.*, Searle Decl. ¶ 16), and others could not be obtained since they were "proprietary" (*e.g.*, *Id.*, Hernandez Decl. Ex. D; No. 41, Hennefer Decl. Ex. L, Doc. No. 2919) or they were made for Kodak (*e.g.*, Record, No. 40, Searle Decl. ¶ 15).

Other, competent evidence supports the conclusion that parts are available from other sources. For example, appellants claim that 90% of the replacement parts for Kodak equipment are made outside Kodak, but they have no admissible evidence that they cannot obtain those parts. A.O.B. at 15. Appellants also claim that two year old copiers have a value of $2500, less than 4% of what they cost new. *Id.* at 10. Cannibalizing those cheap used machines is an obvious source of inexpensive parts. Finally, appellants offered no evidence that they could not manufacture the parts themselves. Entry into the far more complex equipment markets has been achieved by many competitors in recent years.

The critical question is whether appellants can find parts elsewhere. On that issue they have presented no evidence at all. Without such evidence, there is no basis for rejecting Kodak's freeriding argument, much less as a matter of law.

II. THE MONOPOLIZATION CLAIM

A. The Majority Misapprehends the Aspen Exception.

The majority agrees with the district court's statement that "Kodak had no duty to deal with its competitors." Opinion at 3641. But it relies on the unique exception created in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 608 (1985), to reach a contrary result.[10]

The majority's reading of the exception swallows the rule. It certainly goes beyond this Court's reading of

[10] The majority agrees that appellants did not raise this argument in their brief below, but it is "not confident enough" that the district court somehow did not think of and consider appellants' new argument. Opinion at 3640 n. 7. The majority's consideration of this new argument, on that ground, overrides long-standing rules in this Circuit. Before now, the Court had discretion to hear new arguments in three exceptional situations, none of which applies. *See Bolker v. C.I.R.*, 760 F.2d 1039, 1042 (9th Cir. 1985) (new argument not considered where analysis required detailed factual inquiry and relevant facts might not have been presented below); *Huettig & Schromm, Inc. v. Landscape Contractors Council*, 790 F.2d 1421, 1426 (9th Cir. 1986) (no consideration of argument where, as here, it was not discussed in opposition papers below and entire thrust below was different).

Aspen in *Oahu Gas Service, Inc. v. Pacific Resources Inc.*, 838 F.2d 360, 368 (9th Cir.), *cert. denied*, 109 S.Ct. 180 (1988).[11] The majority would require Kodak, absent a legitimate business justification, to sell parts to ISOs on the theory that those parts are an "essential" facility. Opinion at 3641. That theory necessarily, but inaccurately, assumes that appellants have no alternative parts supplies.

Appellants bear the burden of proving the parts are unavailable and that competition is harmed by Kodak's refusal to sell them to ISOs. As the Second Circuit recently found, "the word 'essential' indicates [that] a plaintiff must show more than inconvenience, or even some economic loss; he must show that an alternative to the facility is not feasible." *Twin Laboratories, Inc. v. Weider Health & Fitness*, 1990 U.S. App. Lexis 5466 at 11 (2d Cir., No. 89-7972, April 9, 1990) (affirming summary judgment on essential facilities and attempted monopolization claims). Here, there is no evidence that Kodak is the only feasible source of parts. *See* pp. 11-12, above.

The majority overlooks this defect in appellants' evidence. Since the undisputed evidence is that Kodak is not an essential facility for parts, the monopolization claim fails.

[11] *See also U.S. v. Syufy Enterprises*, 1990 U.S. App. Lexis 7396 at 6-7 (9th Cir., No. 89-15475, May 9, 1990) ("[U]ltimately the court must resolve a practical question in every monopolization case: Is this the type of situation where market forces are likely to cure the perceived problem within a reasonable period of time?")

B. There Is No Genuine Issue Regarding Kodak's Lack Of Monopoly Power.

The majority agrees that, to be held liable for monopolization, Kodak must "possess monopoly power in the relevant market" and that monopoly power "is something more than the market power that is a prerequisite to liability under section 1." Opinion at 3640, 3643. The majority states that the issue of monopoly power is "not as easily answered" as the issue of market power, but concludes that economic "theory" once again *might* not "mirror" economic "reality." *Id.* at 3643.

For the same reasons that the majority misapprehends the significance of Kodak's economic logic concerning the Section 1 issue of market power, the majority *a fortiori* misapprehends appellants' failure to raise any genuine issue of fact regarding Kodak's lack of monopoly power. Indeed, the majority compounds the error of its Section 1 formula. It necessarily concludes that:

LESS THAN MARKET POWER + UNKNOWN FACTORS = MONOPOLY POWER

But that conclusion flies in the face of all existing law, economic logic and common sense.

C. There Is No Genuine Issue Regarding Kodak's High Quality Service Business Justification.

Kodak presented detailed evidence of a strategy based on the marketing of high quality service and its need to maintain responsibility for service. Appellee's Brief at 9-11. *See* Record, No. 14, Murray Decl. ¶¶ 13, 18, 19, 22, 26, 30, Exs. 3, 4, 5; No. 15, Lacy Decl. ¶ 11, 12, 19,

20, 25, 27, Exs. 2, 3. That evidence was never disputed by appellants. Therefore, the Section 2 claim should have been dismissed. *Mozart*, 833 F.2d at 1350-52.

The majority states that there is an issue of fact as to whether Kodak's desire to maintain high quality service is "genuine rather than pretextual." Opinion at 3642. But the evidence it cites is only an example of a refusal to sell parts following an ISO's winning of service contracts. *See Id.* at 3638. That example says nothing about Kodak's desire to maintain high quality service. Appellants have never disputed that Kodak has such a desire and that the desire makes sense. Since the evidence about the service justification is unchallenged, there is no basis for a trier of fact to conclude that the justification was not genuine. As *Mozart* held and Judge Wallace concludes, that is true regardless of the existence of other evidence of anticompetitive intent. Dissent at 3650. *See also Oahu Gas Service*, 838 F.2d at 368-69.

SUGGESTION FOR REHEARING EN BANC

Kodak suggests rehearing of this matter *en banc*, under FRAP 35(a), to secure and maintain uniformity of the Court's decisions, and under Circuit Rule 35-1, in light of a direct conflict with other courts of appeal with respect to a rule of national application in which there is an overriding need for national uniformity. Every manufacturer of high technology systems faces the same antitrust penalty if the majority opinion stands. *See, e.g*, amici brief of Hewlett-Packard, Digital, Data General and Wang. In addition, another pending appeal, *Datagate, Inc. v. Hewlett-Packard Co.*, No. 88-15293, raises the same

issues and submission in that case has been withdrawn pending the decision in this matter. Order, November 22, 1989 (copy attached).

CONCLUSION

For the reasons stated above, Kodak respectfully requests that the Court grant a rehearing or that the matter be heard *en banc*. Dated: May 15, 1990.

Respectfully submitted,

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IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

NO. 88-2686

IMAGE TECHNICAL SERVICES, INC., et al.,

Plaintiffs-Appellants,

v.

EASTMAN-KODAK COMPANY,

Defendant-Appellee.

APPEAL FROM THE JUDGMENT OF THE
UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

Case No. C-87-1686-WWS

BRIEF *AMICUS CURIAE OF*
DIGITAL EQUIPMENT CORPORATION, HEWLETT-PACKARD COMPANY AND WANG LABORATORIES INC. IN SUPPORT OF PETITION FOR REHEARING AND SUGGESTION OF REHEARING *EN BANC*

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No. 88-2686: Image Technical Services, Inc., et al., Plaintiffs-Appellants, v. Eastman Kodak Co., Defendant-Appellee

Certificate Required by Circuit Rule 28-2.1

Pursuant to Ninth Circuit Rule 28-2.1, the undersigned counsel of record for *amicus curiae* Digital Equipment Corporation, Hewlett-Packard Company and Wang Laboratories Inc. certifies that there are no known interested parties other than those participating in the case.

This representation is made to enable judges of the court to evaluate possible recusal.

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Interest of Amicus Curiae

Digital Equipment Corporation, Hewlett-Packard Company and Wang Laboratories Inc. (collectively, "amici") compete with each other and many other firms in the business of supplying computer system solutions for a multitude of data processing requirements. These firms vie to supply the highest-performance, lowest-cost combinations of hardware, software and service to meet the demands of buyers adept at comparing the overall performance and cost of owning these systems. The quality and price of post-sale service are critical to the competitiveness of each firm's systems. No firm has the power or incentive to take advantage of its system users by lowering the quality or raising the price of such service; any firm attempting to do so would quickly lose system sales and place at risk its entire systems business. Computer users have greatly benefited from the explosive rate of technological change and the resulting decline in the cost of computing power fostered by intense systems competition.

The computer industry shares these essential characteristics with the copier and micrographic equipment industries involved in this case. These realities of the computer and similar industries are at the heart of numerous precedents in this Circuit and elsewhere rejecting attempts by antitrust plaintiffs to label any one firm in the industry as a "monopolist" in or as having "market power" over a "market" limited to one isolated part of that firm's overall systems business. Under these precedents, the service of a single manufacturer's equipment *cannot* be a relevant antitrust market because of the inextricable relationship between such service and the overriding fact of interbrand equipment competition.

The majority opinion misapplies these controlling precedents. The result, if allowed to stand, could permit a jury to find that Kodak possesses market or indeed monopoly power over the service of Kodak equipment notwithstanding plaintiffs' admission that Kodak lacks interbrand market power. Such a result makes no economic sense and thus cannot make antitrust sense. Whatever impact Kodak's parts policies might have had on independent service *competitors*, those policies could not have adversely affected *competition* absent Kodak's possession of market power in the interbrand equipment business. The misapplication of market definition and market power principles in this case could actually impair competition by restraining the freedom of equipment manufacturers to innovate with regard to their service operations so as to enhance the overall competitiveness of their equipment.

Amici have faced similarly groundless antitrust charges in this Circuit and elsewhere in connection with

their service businesses. We thus have an interest in the correct application of market definition and market power principles to our high technology industry, so as to preserve our ability to compete vigorously for system sales.

Reasons for Granting the Petition and Suggestion

1. Inconsistency With General Business Systems

The majority opinion cannot be squared with this Court's decision in *General Business Systems v. North American Philips Corp.*, 699 F.2d 965 (9th Cir. 1983).[1] This Court there held that, *as a matter of law*, competition in the interbrand market (for small business computer systems) precluded the exercise of market power over parts or service for such systems. *Id.* at 972-75. At the outset of its discussion, this Court observed that the "district court rejected as a matter of law" plaintiff's market definition (limited to magnetic ledger cards ("mlcs") used in defendant's computer systems) and stated that "[i]t is this interpretation of the law that we must review." *Id.* at 972. This Court agreed with the district court that defendant's undisputed lack of market power in the interbrand market compelled the conclusion "that the market for mlcs cannot be separated from the general market for small

[1] Because the majority opinion irreconcilably conflicts with *General Business Systems*, *en banc* review is both appropriate and necessary. *Atonio v. Wards Cove Packing Co.*, 810 F.2d 1477, 1478-79 (9th Cir. 1987); *Charleston v. United States*, 444 F.2d 504, 506 (9th Cir.), *cert. denied*, 404 U.S. 916 (1971).

business computer systems" and that, accordingly, defendant lacked market power over those mlcs. *Id.*[2]

In short, the *dispositive* fact in *General Business Systems* was defendant's lack of market power in the interbrand market. Similarly, here, it was undisputed that Kodak lacks interbrand market power. 90 C.D.O.S. 3625, 3634 n.3 (hereafter, "Op. at ___"). Under *General Business Systems*, that undisputed fact is dispositive because, as a matter of law, interbrand competition prevents the exercise of market power in any hypothetical intrabrand market for parts or service. The district court thus properly entered summary judgment and did *not* err by denying plaintiffs additional discovery; such discovery could not have yielded evidence sufficient to create a triable issue where plaintiffs did not dispute Kodak's lack of interbrand market power.

The majority's effort to distinguish *General Business Systems* by alluding to alleged factual differences between the two cases is unavailing. The majority cited "evidence"[3] that (a) "Kodak charges up to twice as much as

[2] Thus the Court agreed (699 F.2d at 972) with the district court that

> Philips had little or no power to raise the price of its mlcs without reducing its profits because any such increase would diminish sales of its computer system and very likely adversely affect aggregate profits. Were mlc prices significantly increased, computer system buyers quickly could shift to other sellers who, in turn, could profitably expand their output to meet the new demand.

[3] We understand that such evidence consists in its entirety of multiple hearsay statements that would not be admissible

(Continued on following page)

appellants for service that is of lower quality"; (b) "in some instances competition from ISOs drove down the price that Kodak was willing to charge for service"; and (c) "in other instances some owners of large Kodak equipment packages will pay higher prices for Kodak service rather than switch to competitors, systems." Op. at 3636.

Such evidence fails to raise a triable issue. Higher prices for Kodak service *could* be suggestive of market power "under proper circumstances," *General Business Systems*, 699 F.2d at 977, but no such circumstances exist in *this* case.[4] To the contrary, the evidence indicated that differences in prices reflected differences in costs, such as Kodak's maintenance of a $16 million parts inventory that was maintained substantially for the benefit of ISOs, which were thereby subsidized by Kodak's investment

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under Fed. R. Evid. 802-04. *See* Record, No. 40, Hernandez Dec. Such evidence does not create a triable issue, because a party opposing summary judgment must "set forth such facts as would be admissible in evidence." Fed. R. Civ. P. 56(e).

[4] As this Court made clear just last week, in an opinion joined by Judge Wiggins, one such circumstance that is not only proper but *essential* to any inference of market power is a showing of "significant barriers to entry"; absent that circumstance, "any attempt to raise prices above the competitive level will lure into the market new competitors able and willing to offer their commercial goods or personal services for less." *United States v. Syufy Enterprises*, 90 C.D.O.S. 3194, 3196 (9th Cir. May 9, 1990). There is no basis for finding any such barriers protecting Kodak's ability to *maintain* higher prices; absent such barriers, the mere fact that Kodak might have been charging higher prices at some point in time cannot suffice to create a genuine issue as to its market power.

and could thereby avoid this cost.[5] Plaintiffs presented *no* evidence supporting their assertion that Kodak's higher prices resulted from the exercise of market power. Conduct as consistent with lawful competition as with unlawful competition does not, standing alone, create a triable issue. *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986).

The possibility that Kodak charged more than ISOs at one point in time does not mean that it has the power to sustain higher prices over a period of time long enough to permit a trier of fact reasonably to conclude that it has market power. *See Syufy*, 90 C.D.O.S. at 3196-97 ("[i]n evaluating monopoly power it is not market share that counts, but the ability to *maintain* market share" (emphasis by the Court)). Indeed, as the majority found, in the short run, "competition from ISOs drove down the price that Kodak was willing to charge for service" (Op. at 3636), thus suggesting that Kodak lacks the power to sustain higher prices.[6] Over the long run, as this Court held with respect to the tying claim in *General Business Systems*, 699 F.2d at 977, interbrand competition forecloses Kodak from sustaining higher prices; any attempt to do so would only "hasten[] the date on which [Kodak] surrender[s] to its competitors" in the equipment market.

Moreover, the issue is whether Kodak has market power over the *tying* product — parts. Evidence that Kodak maintains higher prices or lower quality for the

[5] *See* Brief of Appellee at 11-12 (Nov. 10, 1988).

[6] Thus, this evidence, far from distinguishing *General Business Systems*, shows that Kodak lacks market power.

tied product — service — is irrelevant to that issue. The possibility that Kodak may have power over the tied product does not mean that it has power over the tying product.

The possibility that some Kodak equipment owners will pay higher service prices rather than switch to competitors' equipment is just a different way of advancing the "lock-in" notion that this Court has repeatedly rejected. In *General Business Systems, id.* at 975, this Court rejected the lock-in theory as a matter of law, stating that such an approach "would dictate that a manufacturer, facing competition against which it cannot prevail in the sale of its end product, could be found to monopolize the market for each unique component that goes into the product. This is surely to lose sight of the forest because of fascination with the trees." Other decisions in this Circuit have similarly rejected the lock-in theory as a basis for finding market power.[7] *Accord Telex Corp. v. IBM Corp.*, 510 F.2d 894, 917 (10th Cir.), *cert. dismissed*, 423 U.S. 802 (1975).

The only case even arguably supporting the lock-in theory is *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 473 U.S. 908 (1985). There, however, this Court did *not* find that an alleged

[7] *Kaplan v. Burroughs Corp.*, 611 F.2d 286, 293-95 (9th Cir. 1979), *cert. denied*, 447 U.S. 924 (1980); *ILC Peripherals Leasing Corp. v. IBM Corp.*, 458 F.Supp. 423, 429 (N.D. Cal. 1978), *aff'd sub nom. Memorex Corp. v. IBM Corp.*, 636 F.2d 1188 (9th Cir. 1980), *cert. denied*, 452 U.S. 972 (1981); *Delta Sys., Inc. v. TRW, Inc.*, slip op. at 4-5, No. C-81-1296 (RMB) (W.D. Wash. May 26, 1987), *aff'd*, 874 F.2d 815 (9th Cir. 1989) (table).

lock-in effect conferred market power on the defendant; it simply observed that lock-in "enhanced" economic power that the Court had already found from the existence of a copyright. 734 F.2d at 1341-43. *Digidyne* has been roundly criticized by other courts of appeals,[8] and this Court and courts within this Circuit have declined to apply it. *Mozart Co. v. Mercedes-Benz of North America, Inc.*, 833 F.2d 1342, 1346 & n.4 (9th Cir. 1987), *cert. denied*, 109 S. Ct. 179 (1988); *Tominaga v. Shepherd*, 682 F. Supp. 1489, 1495 & n.5 (C.D. Cal. 1988).[9]

Finally, the majority deemed significant the fact that, while Philips' share of its interbrand market never exceeded 5%, Kodak's share of its interbrand markets at one time approached as much as 23%. Op. at 3637. That is

[8] *A.I. Root Co. v. Computer/Dynamics, Inc.*, 806 F.2d 673, 677 & n.3 (6th Cir. 1986); *Will v. Comprehensive Accounting Corp.*, 776 F.2d 665, 673 n.4 (7th Cir. 1985), *cert. denied*, 475 U.S. 1129 (1986).

[9] In an *amicus curiae* brief urging the Supreme Court to grant a writ of certiorari in *Digidyne*, the United States Department of Justice explained that the lock-in theory is unacceptable as a matter of sound economics because it improperly focuses only on the customer's post-purchase as opposed to pre-purchase alternatives. According to the Department, "the relevant time frame for measuring the seller's competitive position is when the buyer entered into the contract in preference to some alternative arrangement." Brief for the United States as Amicus Curiae at 15, *Data Gen. Corp. v. Digidyne Corp.*, No. 84-761 (U.S. May 1985). The lock-in theory "ignores how competition in the market operates," "depart[s] from commercial and economic reality" and "skews proper analysis" by erroneously assuming that buyers take no steps to avoid lock-in at the time of purchase and that the seller has no need or desire to attract new customers. *Id.* at 14-17.

an utterly meaningless distinction, however, in light of the *undisputed* fact that Kodak lacks market power in the interbrand markets. In any event, the Supreme Court has held that a 30% share is insufficient to show market power in a tying case. *Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2, 26-27 (1984).

2. The Section 2 Monopoly Power Claim

On the Section 2 refusal to deal claim, the majority admitted to "hav[ing] more trouble with the monopoly power . . . issue" (Op. at 3642) because monopoly power "is something more than the market power that is a prerequisite to liability under Section 1" (*id.* at 3643). As stated above, however, plaintiffs failed to present significant probative evidence to overcome summary judgment on their Section 1 claim. Since monopoly power under Section 2 is "something more" than market power under Section 1, they necessarily also failed to present significant probative evidence on their Section 2 claim.

Moreover, the majority's holding as to the relevant product market for the Section 2 claim cannot be squared with either *General Business Systems* or *Bushie v. Stenocord Corp.*, 460 F.2d 116 (9th Cir. 1972). Plaintiffs defined the relevant market as the service of Kodak equipment. *See Op.* at 3642. The majority found a triable issue on that definition because, in its view, "[t]his court has strongly suggested that service of one company's micrographic equipment can be a relevant market under Section 2." *Id.* (citing *Dimidowich v. Bell & Howell*, 803 F.2d 1473, 1480-81 n.3 (9th Cir. 1986), *modified*, 810 F.2d 1517 (9th Cir. 1987)).

Dimidowich does not remotely stand for any such proposition. Its intimation that service of a product and the product itself may be viewed separately was *solely* for purposes of determining whether two firms competed with each other and thereby determining whether their alleged concerted refusal to deal was a horizontal or vertical restraint under Section 1. The Court was not called on and did not purport to engage in the cross-elasticity of supply and demand and other analyses required to define a market under Section 2. At most, therefore, the Court's colloquial use of the word "market" was *dictum*.

Contrary to the majority's assertion, this Court has consistently rejected market definitions limited to a single manufacturer's equipment or to service therefor. In *General Business Systems*, 699 F.2d at 972, this Court rejected, as a matter of law, a market definition limited to mlcs used in defendant's computer systems in light of undisputed evidence of competition in the systems market. Numerous cases in this Circuit and elsewhere reject market definitions limited to one element of one manufacturer's products.[10]

This Court has also rejected efforts to define a market limited to servicing one manufacturer's products. In *Bushie*, 460 F.2d at 121, this Court affirmed summary

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[10] *In re IBM Peripheral EDP Devices Antitrust Litigation*, 481 F.Supp. 965, 985 (N.D. Cal. 1979), *aff'd sub nom. Transamerica Computer Co. v. IBM Corp.*, 698 F.2d 1377 (9th Cir.), *cert. denied*, 464 U.S. 955 (1983); *ILC Peripherals*, 458 F.Supp. at 429; *A.I. Root*, 806 F.2d at 675; *Telex*, 510 F.2d at 919; *Allen-Myland, Inc. v. IBM Corp.*, 693 F.Supp. 262, 272-79 (E.D. Pa. 1988).

judgment against a complaint alleging a relevant market limited to servicing Stenocord equipment because there was no evidence "that Stenocord dominated the market for office dictating machines generally, or that it controlled a major share of the market for machines of its particular type."[11]

Under *General Business Systems, Bushie* and these other cases, there can be no market limited to one element (such as servicing) of one manufacturer's products if competition with other manufacturers prevents the exercise of monopoly power over the one element alleged to be the relevant market. In this case, the undisputed fact of interbrand competition precludes definition of a market limited to servicing Kodak equipment.

The majority's departure from this established market definition principle could invite groundless antitrust charges *whenever* an equipment manufacturer modifies its service arrangements to enhance its *interbrand* competitiveness in a manner not to the liking of intrabrand independent service firms. The threat that such litigation will survive summary judgment and advance to the point of permitting a jury to find "monopolization" of such a "market" chills precisely the kind of innovation and competition that the antitrust laws are intended to foster.

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[11] *See also Spectrofuge Corp. v. Beckman Instruments, Inc.*, 575 F.2d 256, 278-86 (5th Cir. 1978) (no market for servicing Beckman scientific instruments because service is an integral part of the equipment market), *cert. denied*, 440 U.S. 939 (1979); *Delta Sys.*, slip op. at 5 (granting summary judgment because alleged market for servicing Singer "System Ten" computers "is not warranted by the facts of the computer industry").

3. Misapplication of Summary Judgment Standards

The majority misapplied controlling standards for granting summary judgment in antitrust cases. On the market power issue, the majority conceded that interbrand competition "might prevent Kodak from possessing power in the parts market," that "equipment purchasers might turn to one of Kodak's competitors if Kodak ties supercompetitively priced service to parts," and that Kodak's "desire to attract new customers might, therefore, keep it from charging supercompetitive prices for service." Op. at 3634-35. Nevertheless, it concluded (*id.* at 3635-36 (citation omitted)) that it could not

> uphold the district court's grant of summary judgment on this theoretical basis. . . . [M]arket imperfections can keep economic theories about how consumers will act from mirroring reality. . . . While appellants have not conducted a market analysis and pinpointed specific imperfections in the copier and micrographic markets, a requirement that they do so in order to withstand summary judgment would elevate theory above reality.

This approach ignores the Supreme Court's holding that "the mere existence of *some* alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment; the requirement is that there be no *genuine* issue of *material* fact." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247 (1986) (emphasis by the Court). Thus, to show a "genuine" issue for trial in an antitrust case, a plaintiff "must do more than simply show that there is some metaphysical doubt as to the material facts" and "if the factual context renders [plaintiffs'] claim implausible — if the claim is one

that simply makes no economic sense — [plaintiffs] must come forward with more persuasive evidence to support their claim than would otherwise be necessary." *Matsushita*, 475 U.S. at 586-87.

In *Richards v. Neilsen Freight Lines*, 810 F.2d 898, 902 (9th Cir. 1987), then-Judge Kennedy elaborated:

> It is the record made on summary judgment that controls, not that record plus speculative inferences a trier of fact might add; and the only inferences permitted from the summary judgment record itself are those that are reasonable given the substantive law which is the foundation for the claim or defense. Where a party asserts there is a genuine issue for trial . . . its argument is measured by the underlying theory of the claim or defense being considered. . . . [T]he substantive law is the law of antitrust, and if the claim makes no economic sense, a speculative inference from the jury will not help it. In such an instance, the record on summary judgment must contain further persuasive evidence if it is to support the claim.

Accord Eichman v. Fotomat Corp., 880 F.2d 149, 161 (9th Cir. 1989); *Ferguson v. Greater Pocatello Chamber of Commerce, Inc.*, 848 F.2d 976, 979 (9th Cir. 1988).[12]

The majority opinion in this case is contrary to these settled principles. The majority recognized the economic logic of Kodak's claim that interbrand competition precludes market power over parts or service, thus necessarily recognizing the economic *illogic* of plaintiffs' claim

[12] Indeed, Judge Wiggins, the author of the majority opinion in this case, recognized these sound principles in *Christofferson Dairy, Inc. v. MMM Sales, Inc.*, 849 F.2d 1168, 1172 n.4 (9th Cir. 1988), but failed to apply them in this case.

that Kodak has such power. But far from requiring plaintiffs to provide "significant probative evidence" to support their claim, the majority simply speculated that "market imperfections" may be present in this case. Op. at 3635-36. It did not identify what those "imperfections" might be or impose on plaintiffs the burden of doing so because, in its view, that would somehow "elevate theory above reality." *Id.* at 3636.

But *Matsushita* and *Richards* impose just such a burden and require an antitrust plaintiff to present exceptionally persuasive evidence in opposition to a summary judgment motion where, as here, its claim does not make economic sense. Most importantly, these decisions preclude a court from denying summary judgment on the basis of speculative inferences such as the unidentified "market imperfections" cited in this case. Indeed, *Richards* expressly states that the question whether there is a triable issue *is* measured by the underlying theory of the claim or defense being considered. 810 F.2d at 902.

This Court has previously warned against "giv[ing] free rein to any plaintiff who can draft an antitrust complaint capable of withstanding a motion to dismiss to go to trial with only a wing and a prayer. . . . " *Mutual Fund Investors, Inc. v. Putnam Management Co.*, 553 F.2d 620, 624 (9th Cir. 1977). This is because "the statutory private antitrust remedy of treble damages affords a special temptation for the institution of vexatious litigation." *Lupia v. Stella D'Oro Biscuit Co.*, 586 F.2d 1163, 1167 (7th Cir. 1978), *cert. denied*, 440 U.S. 982 (1979). Unless corrected, the majority opinion could encourage the filing of just the sort of meritless and vexatious complaints that *Matsushita* and *Richards* were intended to forestall and that inhibit an equipment manufacturer in its adaptation of service offerings to promote consumer preference for

its equipment. At minimum, the conflict between *Richards* and the majority in this case warrants rehearing *en banc*.

Conclusion

For the foregoing reasons, Kodak's petition for rehearing and suggestion of rehearing *en banc* should be granted.

Respectfully submitted,

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Dated: May 15, 1990

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

NO. 88-2686

IMAGE TECHNICAL SERVICES, INC., et al.,

Plaintiffs-Appellants,

v.

EASTMAN KODAK COMPANY,

Defendant-Appellee.

APPEAL FROM THE JUDGMENT OF THE
UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

Case No. C-87-1686-WWS

APPELLANTS' RESPONSE TO PETITION FOR REHEARING AND SUGGESTION FOR REHEARING *EN BANC*

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INTRODUCTION

No court has ever held — or should hold — what Kodak and *amici* request: that in *every* case where interbrand competition exists in equipment, summary judgment automatically bars a tying claim in *any* equipment-related "aftermarkets"[1] (presumably including parts, service, accessories, peripherals, etc).

Determination of market power turns upon the specific facts presented. Kodak argues that the majority erred in finding triable issues regarding market power because it ignored the "irrefutable economic principle" that if Kodak lacks power in the equipment market, it cannot "exercise power in a derivative aftermarket" such as repair parts. Kodak Petition ("K.P.") at 1.

Kodak and *amici* want this Court to discard extensive precedent that market power is fact-specific and replace it with generalized economic theory: that so long as a manufacturer competes at the equipment level, it can act with impunity in all related "aftermarkets," and cut off all antitrust challenges by summary judgment.

Even if some court were to declare erroneously that "aftermarkets" are "antitrust-free zones," that would simply recast the factual inquiry into a new question: What

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[1] Kodak and *amici* never precisely define "aftermarket," and with good reason. For if they succeed in reversing the majority, manufacturers such as Kodak, Hewlett-Packard, Wang, Digital Equipment and others will be given carte blanche to monopolize through ties or refusals to deal all their various "aftermarket" product lines if they face competition in one related product line.

constitutes an "aftermarket"? Parts? Service? Accessories? Enhancement devices? Peripherals? How "peripheral" must a peripheral be to constitute an "aftermarket" rather than an independent market? The factual inquiry into relevant market currently required by unbroken precedent, culminating in the majority here, resolves these questions. Giving Kodak an "aftermarket exemption" from tie-ins would add a new definition to the antitrust lexicon without providing any meaningful guidance.

The district court here, because it failed to grasp the tying arrangement, denied appellants factual discovery on relevant market and power therein. Thus, the majority found "a record that was not fully developed through discovery. . . . " Opinion ("Op.") at 3635. Nonetheless, the majority correctly concluded that appellants presented sufficient credible evidence to raise triable issues regarding Kodak's power over parts, to which it ties its service. This evidence (discussed below) consists of: the reality of market imperfections that destroy the abstract theoretical model Kodak advanced (and reiterates here); the reality that Kodak owners are "locked-in" to their equipment; and the reality that Kodak parts are unique. Op. at 3633-34. These showings would enable a trier to find a *per se* tie.[2]

[2] *Jefferson Parish Hospital Dist. No. 2 v. Hyde*, 466 U.S. 2, 16-17 (1984) (market imperfections, unique product can result in market power); *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336, 1342-43 (9th Cir. 1984), *cert. denied*, 473 U.S. 908 (1985) (lock-in can enhance market power); *Dimidowich v. Bell & Howell*, 803 F.2d 1473, 1481 n. 3 (9th Cir. 1986), *modified* 810 F.2d 1517 (9th Cir. 1987) (parts and service are brand-specific).

Kodak's second major argument depends on its first: since power over parts is theoretically "impossible" given competition in equipment, it was error to reverse summary judgment and remand for further discovery. Kodak claims *Matsushita Elec. Indus. Co. v. Zenith Radio*, 475 U.S. 574 (1986), holds that if an antitrust claim " 'is one that simply makes no economic sense,' plaintiff's burden to survive summary judgment increases." K.P. at 1. *Matsushita* is inapplicable.

In *any* Rule 56 case, antitrust or not, the non-moving party is entitled to "an opportunity to make full discovery." *Celotex Corp. v. Catrett*, 477 U.S. 317, 326 (1986). Until that opportunity is afforded, the evidence in opposition to summary judgment need not be admissible at trial. *Id.* at 324. *Matsushita* only holds that a plaintiff who has conducted full discovery but alleges an "implausible" conspiracy must oppose summary judgment "with more persuasive evidence to support [its] claim than would otherwise be necessary." 475 U.S. at 587. *Matsushita* does *not* hold that where some economic *theory* suggests no unlawful restraint on competition *should* occur, discovery must be denied in the face of evidence that *reality* is contrary to the theory. Because appellants' evidence (such as they were permitted to discover) was contrary to Kodak's theory, it was not error to reverse.

I. THE MAJORITY CORRECTLY HELD THAT TRIABLE ISSUES EXIST REGARDING KODAK'S TYING ARRANGEMENT.

A. Appellants Presented Triable Issues Of Whether Kodak Has Engaged In A Tie-In That Is Unlawful Per Se.

Kodak and *amici* attack the majority's legal precedents but ignore (except for attacking its admissibility)

the *evidence* presented, which demonstrates triable issues on all three *per se* tying elements. These are: (i) two distinct products or services, with purchase of one conditioned on purchase of the other, or, on an agreement not to purchase the other from another supplier; (ii) sufficient economic power in the first (tying) market to restrain competition in the second (tied) market; and (iii) an effect on a not-insubstantial volume of commerce in the tied market. *Mozart Co. v. Mercedes-Benz of North America. Inc.*, 833 F.2d 1342, 1345 (9th Cir. 1987), *cert. denied*, 109 S.Ct. 179 (1988). It is settled that Kodak will not sell parts (tying product) to an equipment owner unless that owner also purchases Kodak service (tied product) or at least agrees not to use appellants' service. Op. at 3631-33; Dissent ("Dis.") at 3643-44. The district court simply missed the tie. This major error has been corrected. Op. at 3631-32.

i. Two Distinct Products/Services – Conditioning.

There is no dispute that triable issues exist with respect to the first element, as Judge Wallace acknowledged (Dis. at 3644):

> I agree with the majority that Image Tech has raised triable issues as to whether Kodak's business practices constitute a tying arrangement.[3]

[3] Judge Wallace's observation disposes of Kodak's refusal to "concede" the tie (K.P. at 3 n.1) and its argument that its parts policies constitute exclusive dealing rather than a tie-in.

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ii. Market Power In The Tying Product.

Appellants' evidence raised triable issues on the second element, market power in parts (the tying product).

(a) Market Imperfections.

The determination of relevant market and power therein "is basically a fact question, dependent upon the special characteristics of the industry involved." *Oahu Gas Service, Inc. v. Pacific Resources, Inc.*, 838 F.2d 360, 363 (9th Cir. 1988). The district court did not reach these issues; the majority read *Jefferson Parish* against appellants' limited facts and concluded:

> Viewed in the light most favorable to appellants, the evidence that they have presented is sufficient to raise a material issue of fact as to whether Kodak has power in the parts market." Op. at 3637.

The majority noted that competition in equipment "might prevent" Kodak from exerting power over parts (Op. at 3634) but held that this economic theory could not substitute for the factual analysis required by *Jefferson Parish*, including analysis of market imperfections. Op. at 3635-36.

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K.P. at 8-10. As demonstrated in appellants' Reply Brief, Kodak cannot take refuge in exclusive dealing cases such as *Bushie v. Stenocord Corp.*, 460 F.2d 116 (9th Cir. 1972), because these cases do not sanction "impermissible methods" such as tie-ins to effectuate exclusive dealing arrangements. *Dimidowich*, 590 F. Supp. at 49-50, n.7.

Market imperfections that can "keep economic theories about how consumers will act from mirroring reality" (Op. at 3635-36) are demonstrably not "unknown factors" or "undefined," as Kodak sarcastically asserts. Rather, the majority's discussion of market imperfections was directly cited to footnote 24 of *Jefferson Parish*, where, the majority explained, the Supreme Court "note[d] that market imperfections can keep consumers from seeing the price and quality implications of a tying arrangement." *Id*. at 3636.

The majority's *Jefferson Parish* reference states:

> Especially where market imperfections exist, purchasers may not be fully sensitive to the price or quality implications of a tying arrangement, and hence it may impede competition on the merits. *See* Craswell, [Tying Requirements in Competitive Markets: the Consumer Protection Issues, 62 B.U.L. Rev. 661,] at 675-679.

Jefferson Parish, *supra*, 466 U.S. at 15 n. 24.

The Craswell article relied on by the Supreme Court lists a number of market imperfections which may engender tying-market power, corresponding with the facts here. Initially, Kodak sold its parts to anyone, without any tie to service. Kodak purchasers bought Kodak equipment in reliance on this policy, but Kodak changed this policy and refused to sell them parts if they used ISO rather than Kodak service. Op. at 3630. As Craswell states, one "market imperfection" is:

> Discovering whether or not a tie will even be imposed . . . [B]uyers have alleged that they were forced to buy the tied product . . . by the seller's threat to cut off the supply of the tying product after the initial purchases had already begun . . .
>
> Obviously, there will be no harm if the buyer can switch to some other source for the tying product when the original seller begins to insist on a tie. In some cases, though, the buyer would encounter significant transaction costs in switching to another supplier . . . Conceivably, the [seller] could then introduce new tying requirements that the [buyer] would not have originally agreed to, up to the point where the cost of such requirements exceeds the cost of switching to a different [seller's] system.

Craswell, *supra*, at 674-75. The same is true here. Kodak can tie its supercompetitively priced service to its parts up to the point where it would be less costly for the equipment owner to rip out his Kodak installation and switch to a competing manufacturer.

Another major "market imperfection" noted by Craswell relates to prospective Kodak purchasers, who are not omniscient or prescient regarding future costs of parts and service:

> The simplest explanation for tie-ins which do not benefit buyers is that the buyer was not aware of what he was agreeing to. This may be due . . . to the difficulty in calculating in advance of the sale just how much a tie-in is likely to cost over the course of the contract . . . The important point for the moment is that so long as buyers do not *perfectly understand* the tying arrangement, they will get into some ties that they would have preferred to stay out of, and which would represent a net efficiency loss.

Craswell, *supra*, at 672 (emphasis added and footnote omitted).

Thus, one "market imperfection" is that purchasers are not "perfect" — except perhaps in the *perfect* world of Kodak's *theoretical* economic model. A *real* purchaser has difficulty predicting, at the time of purchase, the cost of Kodak's tie-in over the life of the equipment.[4]

Supreme Court recognition that market imperfections can lead to market power, together with appellants' evidence of such imperfections, precludes Kodak's desire to substitute perfect theory for imperfect reality.[5]

(b) Economic Lock-In.

The "lock-in" created by the high cost of Kodak equipment enhances Kodak's power over parts. *Digidyne,*

[4] The district court found that Kodak purchasers tend to keep their equipment for its useful economic life. Excerpts at 70. Although "purchasers of copiers consider costs of maintenance and repair in deciding which brand to buy," (Op. at 3634; Dis. at 3644) their knowledge is far from perfect. The evidence showed that copier purchasers "do not go through life cycle cost analysis for machines before purchasing machines." Record, No. 40, Dec. Hernandez ¶¶ 61-62.

[5] Although the market imperfections advanced in *Jefferson Parish* (principally, a "reference . . . to go to . . . the closest hospital," 446 U.S. at 26) were held *factually* insufficient to confer market power, the Court clearly recognized that other market imperfections, such as inadequate consumer information, properly substantiated, *can* result in market power, *Id.* at 27, and that "Congress has found these market imperfections to exist." *Id.* at 27 n. 45. If, as a matter of law, market imperfections could not suffice, the *Jefferson Parish* court clearly would not have devoted several pages to discussing the factual shortcomings of the imperfections advanced there.

734 F.2d at 1342-43. Unless they self-service, Kodak owners must use Kodak service, regardless of price. *See Dimidowich,* 803 F.2d at 1481 n. 3 (". . . an owner of broken [Bell & Howell] micrographic equipment is indifferent to people who can service Kodak or 3M machines. If the owner's only option is to request service from [Bell & Howell . . .], that is obviously the market the owner faces").[6]

(c) Uniqueness.

Patents and copyrights can confer market power. *Jefferson Parish,* 466 U.S. at 16; *United States v. Loew's, Inc.,* 371 U.S. 38, 45 (1962); *Digidyne,* 734 F.2d at 1341. Some of Kodak's parts are patented, its repair manuals are copyrighted, Kodak is the only source of its unique parts. Op. at 3633. Kodak's successful tie of its unique parts to its service provides further evidence of tying market power.

iii. Not Insubstantial Effect On Commerce.

No party disputes that the final element, effect on commerce in the tied service market, is satisfied.

[6] The lock-in criticisms in the Department of Justice *Digidyne* brief (A.B. at 8 n. 9) presuppose perfect knowledge of the cost of the tie by the buyer at the time of purchase ("pre-purchase alternatives") ignoring the *Jefferson Parish* market imperfection reality that buyers rarely have such knowledge. Purchasers of Kodak equipment before it instituted the tie here certainly did not and *could not* have such knowledge.

B. The Opinion Is Not Inconsistent With *General Business Systems* Or Other Cases On Which Kodak Relies.

Kodak and *amici* contend *General Business Systems v. North American Philips Corp.*, 699 F.2d 965 (9th Cir. 1983), holds that "as a matter of law, interbrand competition prevents the exercise of market power in any hypothetical interbrand market for parts or services." A.B. at 4. It does not.

In *Philips*, the magnetic ledger cards (mlcs) were a *component* of computers that were sold separately but without which the computers would not operate. Mlcs and computers were two parts of *the same product*, and hence could form only *one* market. With no market power in computers, there was *a priori* no market power in a component thereof, mlcs. The Kodak equipment, parts and service here would likely be found to be *separate* products in separate markets. Op. at 3632-33.

Because the computers were inoperable without mlcs, computer purchasers *had* to buy some mlcs when they bought the computer equipment and *were aware* of "the cost of mlcs as a major barrier to purchase," *id.* at 973, precluding a market imperfection. Because Kodak equipment purchasers do not buy spare parts when they buy equipment, they are ignorant of Kodak's tie at time of purchase. "Appellants' evidence distinguishes this case from *Philips*." Op. at 3636.[7]

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[7] *Philips* recognizes that, contrary to Kodak's claim, service can be a separate market from equipment or parts. Philips

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Kodak's reliance on the dissent in *Parts and Electric Motors, Inc. v. Sterling Electric, Inc.*, 866 F.2d 228 (7th Cir. 1988) (competition in equipment in *theory* precludes power over parts) is hardly persuasive. Although Judge Posner would substitute theory for facts, the majority there did not. It affirmed a jury verdict that Sterling had engaged in a *per se* tie by conditioning sale of its unique parts on plaintiff's purchases of motors. 866 F.2d at 232-34.[8] Plaintiffs in *Sterling*, were prospective "buyers" of new motors who had alternative suppliers, not "owners" of equipment needing parts and service who do not.

These cases do not hold that competition in equipment precludes power over parts, but demonstrate that careful factual product analysis is necessary to determine

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tied service to mlcs. This Court agreed that service was a distinct tying product, but held that Philips lacked power over service because it could not raise its service prices to supercompetitive levels. 699 F.2d at 977. "There [was] no evidence that Philips was the exclusive source of service, . . . the tying product. But appellants have presented evidence that many Kodak parts, the tying product, are unique and available only from Kodak." Op. at 3636-37. The Opinion is in perfect accord with *Philips*.

[8] One ground for affirmance was evidence of effective barriers to entry into the tying market (parts) since "the demand for Sterling parts could accommodate only one manufacturer." 866 F.2d at 233. Appellants did not have an opportunity to discover evidence on the likelihood that similar conditions obtain here. Thus, claims about lack of evidence on barriers to entry in the Kodak parts market are premature. A.B. at 5 n. 4.

market power. The majority correctly remanded for such analysis.

II. THE MAJORITY CORRECTLY APPLIED RULE 56 IN REVERSING SUMMARY JUDGMENT

Kodak and *amici* argue that *Matsushita, supra,* imposes a heightened burden on appellants that has not been met because some evidence here may be inadmissible. K.P. at 5-7; A.B. at 11-14, 4 n. 3. They are wrong.

The Supreme Court held in *Celotex Corp. v. Catrett, supra,* that summary judgment can be entered only *"after adequate time for discovery."* 477 U.S. at 322 (emphasis supplied). Unlike the situation here, the *Celotex* Court found that plaintiff had not been "railroaded" by a premature summary judgment motion but had been afforded adequate discovery. *Id.* at 326. The Court noted:

> Any potential problem with such premature motions can be adequately dealt with under Rule 56(f), which allows a summary judgment motion to be denied, or the hearing on the motion to be continued, *if the nonmoving party has not had an opportunity to make full discovery.*

Id. at 326 (footnote omitted, emphasis supplied).

Kodak's summary judgment motion was unquestionably premature: it was filed before appellants conducted *any* discovery. Before their response, appellants were permitted a set of interrogatories, a document request, and six depositions — "only very limited discovery on the market power issue." Op. 3635 n. 4.

Ignoring these discovery handicaps, *Kodak* and *amici* attack the "isolated," "incidental," and allegedly "inadmissible" evidence presented. *Celotex* dispatches these objections:

> We do *not* mean that the nonmoving party must produce evidence in a form that would be *admissible* at trial in order to avoid summary judgment . . . Rule 56(e) permits a proper summary judgment motion to be opposed by any of the kinds of evidentiary materials listed in Rule 56(c), except the mere pleadings themselves. . . .
> 477 U.S. at 324 (emphasis supplied).[9]

The Opinion is consistent with *Matsushita*. There, the Court held that because plaintiffs alleged an implausible conspiracy, they had to produce (after years of discovery) persuasive evidence. *Matsushita's* persuasive evidence requirement in "implausible" claims has been confined principally to conspiracy cases. P. Areeda & H. Hovenkamp, Antitrust Law ¶ 316.1b (Supp. 1989); *Wilcox v. First Interstate Bank of Oregon*, 815 F.2d 522 (9th Cir. 1987); *Richards v. Nielsen Freight Lines*, 810 F.2d 898, 902 (9th Cir. 1987). No such conspiracy allegation is at issue here.

III. THE MAJORITY CORRECTLY HELD THAT SECTION 2 MONOPOLIZATION AND ATTEMPT TO MONOPOLIZE CLAIMS PRESENTED TRIABLE ISSUES

The majority, the dissent, and Kodak acknowledge the existence of the exceptions to unilateral refusals to

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[9] *Accord, Canada v. Blain's Helicopters, Inc.*, 831 F.2d 920, 925-26 (9th Cir. 1987); *Williams v. Borough of West Chester, Pa.*, 891 F.2d 458, 466 n. 12 (3d Cir. 1990); *Bushman v. Halm*, 798 F.2d 651, 655 n. 5 (3d Cir. 1986).

deal that: (1) "[a] monopolist may not refuse to deal with a competitor in an exclusionary attempt to impede competition without a legitimate business reason." Op. at 3641;[10] and (2) "[a] monopolist may not retaliate against a customer who is also a competitor by denying him access to a facility essential to his operations, absent legitimate business justifications." *Ibid.*[11]

Kodak argues that there are no triable issues as to Kodak's business "justifications." This argument has three fatal flaws: (1) business justifications must "predominate" over anticompetitive motives; (2) no cases relied upon have granted summary judgment on this issue; and (3) *Aspen* standards raise triable issues as to the "legitimacy" of Kodak's "justifications."[12]

A. Legitimate Business Reasons Must Predominate.

The dissent's standard to determine whether business "justifications" are "legitimate," is *Calculators*

[10] *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 608 (1985) (*See also, Lorain Journal v. United States*, 342 U.S. 143 (1951)).

[11] *Otter Tail Power Co. v. United States*, 410 U.S. 366, 377 (1973).

[12] Kodak also argues that appellants have not shown that Kodak is the only feasible source of some parts. This clearly is not so. As to patented and copyrighted parts Kodak clearly is the only source. As to other parts as well, ISOs cannot obtain them except through Kodak. Rec. No. 40, Dec. Hernandez ¶¶ 5, 7, 13, 60; Dec. Damiani ¶ 21; Dec. Welch ¶¶ 8, 21; Dec. Tamvacakis ¶ 10; Dec. Searle ¶¶ 15-16.

Hawaii, Inc. v. Brandt, Inc., 724 F.2d 1332, 1339 (9th Cir. 1983), which states:

> It was Calculators' burden to prove that Brandt's acts "were predatory and not *predominantly motivated* by legitimate business purposes." *Lektro Vend Corp. v. Vendo Co.*, 660 F.2d 255, 273 n. 20 (7th Cir. 1981) *cert. denied*, 455 U.S. 921 (1982). Emphasis supplied.

This requires Kodak to show more than just plausible business justifications — which any paid expert can do — it requires factual proof of their "legitimacy" (*Calculators Hawaii*) or "validity" (*Aspen*). This translates to "predominantly motivated." Whether Kodak's proffered business "justifications" or appellants' extensive evidence of anticompetitive intent "predominantly motivated" its actions is a factual issue which is not subject to summary judgment.

B. The "Business Justification" Defense Is Not Subject To Summary Judgment Here.

Every case relied upon by Kodak and the dissent to support the "legitimate business justification" defense was determined on a complete factual record.[13] There is none here.

[13] *Mozart, supra*, 833 F.2d 1342 (substantial evidence at trial supported jury finding of predominance of defendants' business justification); *Calculators Hawaii, Inc. v. Brandt*, 724 F.2d 1332 (9th Cir. 1983) (plaintiff failed to proffer *any* evidence of anticompetitive intent at trial). *Oahu, supra*, 838 F.2d 360 (defendant proved clearly at trial a predominate economic justification).

C. Triable Fact Issues Are Present Under Aspen Standards.

Aspen, like *Calculators Hawaii*, in evaluating the "legitimacy" of the "justifications" applied a "predominance" standard. For example, *Aspen* reasoned:

> Ski Co. did not persuade the jury that its conduct was justified by any normal business purpose . . . The jury may well have concluded that Ski Co. elected to forego these short-run benefits because it was *more interested* in reducing competition in the *Aspen* market over the long run by harming its smaller competitor.

Id. at 608. (Emphasis supplied.)

Appellants showed the same factors from which the *Aspen* court found the business "justifications" of Ski Co. invalid, including: (1) a prior course of business dealings with competitors (ISOs); (2) a new policy (by Kodak) which was "an important change in the character of the market"; (3) substantial impact on competitors (ISOs); and (4) a substantial impact on consumers (Kodak equipment owners). *Aspen*, 472 U.S. at 605.[14]

In *Aspen*, Ski Co. offered Kodak's first "justification," a "desire to disassociate itself from . . . inferior [skiing] services." *Id.* at 609-610. This was rejected by the *Aspen* court because preserving the consumers' opportunity to

[14] *Aspen* additionally set out types of anticompetitive evidence, also presented appellants, that refute Kodak's proffered business justifications, including: (1) statements made by officers or agents of the company; (2) evidence that the conduct was used threateningly and did not continue when a rival capitulated or (3) evidence that the conduct was not related to any efficiency. *Id.* at 608 n. 39.

choose between competitors "allowed consumers to make their own choice on these matters of quality." *Id.* at 610.[15] Appellants also presented substantial evidence directly refuting Kodak's claim of high quality service.[16]

Kodak's second "justification" — reduction of inventory costs — is clearly pretextual and Kodak has not rebutted appellants' logic that "equipment owners' need for Kodak-supplied parts is determined only by the frequency of [Kodak] equipment failure." Op. at 3639. This is even supported by Judge Posner's dissent in *Parts & Electric Motors*.[17] Kodak's "justification" here simply makes no economic sense. Kodak will inventory parts based on the Kodak machine population and may even inventory more parts if it services them all rather than shares service with ISOs.[18]

Kodak's third "justification" — that it has a right to refuse to deal and require ISOs to produce their own

[15] *See, Northern Pacific Ry. v. U.S.*, 356 U.S. at 4, ("the unrestrained interaction of competitive prices will yield the best allocation of our economic resources, the lowest prices, the highest quality").

[16] There was substantial evidence that ISO competitors both lowered price and increased the quality of service. Record, No. 40, Dec. Damiani ¶ 5; Dec. Hernandez ¶¶ 10, 20, 24, 48-50; Dec. Welch ¶ 23-25; Dec. Searle ¶ 7.

[17] "Since Sterling sells only one-tenth of one percent of all industrial motors sold in the United States, it is a reasonable guess that it sells no more than one-tenth of one percent of the replacement parts for industrial motors." 866 F.2d at 236.

[18] Appellants' evidence showed that ISOs inventoried parts themselves, actually reducing Kodak's inventory costs. Record, No. 40, Dec. Welch ¶ 18; Dec. Tamvacakis ¶ 6.

parts to compete in service — falls under *Aspen, Otter Tail* and *Lorain Journal*. Appellants' Section 2 claims are exceptions to Kodak's alleged right or "justification" to refuse to deal.

There are clearly triable issues of fact as to whether Kodak's proffered business "justifications" are "valid," "legitimate" and "non-pretextual" and whether Kodak's acts were "not predominantly motivated by legitimate business purposes."

CONCLUSION

Kodak's petition for rehearing should be denied.

Dated: June 7, 1990

Respectfully submitted,

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